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A pointless war that no one may have wanted and no one can win should stop now: leader

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Politics this week

Jul 20th 2006
From The Economist print edition

AP

Israel continued to batter **Lebanon** in response to an attack on July 12th by the militant group Hizbullah, which still holds two Israeli soldiers captive. Israel hit targets across the country, causing some 300 deaths in the past week for the loss of at least 25 Israeli soldiers and civilians, many killed by Hizbullah rockets reaching as far south as Haifa, Israel's third city. Israel also continued to attack Hamas militants in **Gaza** in an effort to get them to free another recently captured Israeli soldier. See article

Sectarian mayhem continued apace in **Iraq**, with two suicide-bombings alone (one in the holy city of Kufa) killing more than 120 people, mostly Shia Arabs. An Iraqi group swearing loyalty to al-Qaeda claimed responsibility for the Kufa attack.

In the **Democratic Republic of Congo**, several people were shot dead at an election rally in Rutshuru, in the eastern province of Kivu. Separately, the UN-backed committee overseeing the elections called for the army to be confined to barracks until the poll on July 30th.

The Ugandan government and the rebel **Lord's Resistance Army** started talks in the southern Sudanese town of Juba. They had yet to agree the terms for a ceasefire. See article

At a conference in Brussels, Western governments agreed to increase aid to the African Union peacekeeping force in the region of **Darfur**, in Sudan. The force will now have to stay there until at least the end of the year, when the UN may take over.

Protest vote

Several hundred thousand supporters of Andrés Manuel López Obrador, the defeated candidate in **Mexico's** presidential election, took part in a rally in Mexico City to support his demand for a vote-by-vote recount. Mr López Obrador has called for a campaign of civil resistance. See article

Panama's government announced that a referendum on a $5.3 billion project to widen the **Panama Canal** will be held on October 22nd. Opinion polls suggest that the scheme will be approved.

Chile's president, Michelle Bachelet, whose four-month old government has been rocked by protests over education policy, sacked three of her ministers.

Return of the killer waves

AFP

A tsunami struck southern Java, in **Indonesia**, killing more than 500 people. An early-warning system, proposed after the 2004 catastrophe, is not yet operational, but might not have helped much. See article

American-led coalition forces said they and **Afghan** troops retook two Taliban-held towns in Afghanistan's southern province of Helmand.

North Korea halted family reunions with the South, following the latter's cancellation of food aid last week. That, in turn, had followed North Korea's testing of seven missiles.

Authorities in **India** blocked access to several websites, including some of those that host the country's 40,000 blog sites, apparently as a security measure in the wake of the bombings in Mumbai. Free-speech advocates in India criticised the decision.

Australia started to withdraw its troops from **Timor-Leste** as the security situation there began to improve.

The bully pulpit

George Bush used the first veto of his presidency to overturn a decision by Congress to lift restrictions on federal funding for research using embryonic **stem cells**. Mr Bush ordered the ban in 2001 on ethical grounds, but scientists and public opinion are against him. Democrats think the issue will resonate in November's mid-term elections. See article

In **Georgia's** primary elections, Cynthia McKinney, a black congresswoman who became embroiled in a race row after she hit a policeman, faces a run-off after failing to win a majority in her solidly Democratic district. And Ralph Reed, the former leader of the Christian Coalition and once the darling of the right, lost the Republican primary for lieutenant-governor. His campaign was dogged by his former ties to Jack Abramoff, a disgraced lobbyist. See article

The **space shuttle** *Discovery* returned safely from its trip to the international space station. Relieved NASA officials hailed the mission's success.

Valerie Plame and her husband, Joseph Wilson, filed a lawsuit against Dick Cheney, the vice-president, Karl Rove, the president's chief adviser, and Lewis “Scooter” Libby, Mr Cheney's former chief of staff, claiming the trio had sought to discredit them after Mr Wilson, a former ambassador, criticised the White House over Iraq.

Fresh from its success in persuading Warren Buffett to give it most of his money, the **Bill & Melinda Gates Foundation** announced its latest spending plan. Over the next five years, $287m will be available for research leading to the creation of a vaccine against HIV. So far, the search for such a vaccine has been a dismal failure.

Talking the talk

Reuters

World leaders met in St Petersburg for the G8 **summit**. The agenda was inconsequential and the talk was dominated by the Middle East. But the host, Russia's Vladimir Putin, was in triumphant mood since he avoided serious criticism for his slide away from democracy. George Bush and Britain's Tony Blair were embarrassed after being caught by a rogue microphone in an unscripted exchange, which included the memorable greeting, “Yo, Blair!”. See article

Serbia's prime minister, Vojislav Kostunica, offered European foreign ministers a plan to capture Ratko Mladic, a Bosnian Serb general wanted by The Hague war-crimes tribunal. The country's talks with the European Union on possible membership will remain frozen until Mr Mladic is handed over.

The European Commission proposed the creation of a “rapid-reaction” team of border guards to help member governments that are struggling with waves of **illegal immigrants**. Spain's Canary Islands were overwhelmed in May; in the past two weeks, it has been the turn of Malta.

A **Dutch court** rejected a request to ban a paedophile political party that wants to run in November's election on a platform of lowering the age of consent and legalising sex with animals. With only three known members, it is unlikely to win any seats.

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Business this week

Jul 20th 2006
From The Economist print edition

Online gambling companies suffered heavy stockmarket losses after America's Department of Justice signalled a crackdown on the industry by arresting the British boss of a Costa Rica-based gambling firm on racketeering charges. The indictment maintained that gambling online is illegal in the United States, an issue Congress is addressing with legislation that aims to prohibit the popular activity. See article

The scandal surrounding backdated **stock options** intensified as civil, and possibly criminal, charges were readied in the United States. Scores of companies are being investigated by regulators. See article

Amid the usual spree of announcements for aircraft orders at the Farnborough air show near London, **Airbus** unveiled its redesigned A350XWB. The $10 billion revamp of the mid-size aeroplane, which Airbus hopes will win it more customers than Boeing's 787 Dreamliner, comes in response to a demand for more cabin space and greater fuel efficiency. See article

Nyet, or just not yet?

Russia's accession to the **World Trade Organisation** was delayed for at least three months after a row with the United States over meat exports to Russia prevented a much-heralded “breakthrough” at the G8 summit in St Petersburg. Trade officials tried to get the negotiations back on track after Russia also grumbled about negative Western attitudes towards Russian firms. After the falling out, Gazprom, the country's state-controlled natural-gas monopoly, announced a further delay in naming foreign partners for the lucrative $12 billion Shtokman project in the Barents Sea.

Shares in **Rosneft** began trading in London after a last-minute attempt by Yukos, a rival to the state-controlled Russian oil firm, to halt the partial flotation was rejected by a British court. Rosneft's public offering raised $10.4 billion when it was priced last week (making it one of the world's biggest), but Yukos claims the offering is based on the value of assets that were illegally seized from it and sold at state auction. See article

Phelps Dodge, an Arizonan copper miner, sweetened its offer to buy **Inco** and **Falconbridge**, two Canadian nickel and copper mining companies. Amid high metal prices, Phelps Dodge plans to create one of the world's biggest mining concerns, but some of its investors have voiced doubts. In response, **Xstrata**, a Swiss-based mining firm, again raised its offer for Falconbridge in a bid to woo shareholders' support for a separate merger.

The share price of **Yahoo!** fell to its lowest level in two years after it announced a delay to improvements in the technology that marries searches on its website with online advertisers, seen as vital to the firm's competitive strategy.

Microsoft and **Nortel Networks** formed an alliance to develop an internet-based communications system for businesses that will incorporate a range of e-mail and video technologies. The tie-up follows other recent pacts in the telecoms and network-equipment industry.

There's no pleasing some

Citigroup's second-quarter profit and revenue rose, compared with a year ago, boosted by the performance of its investment and corporate-banking business. But despite the solid results the firm's share price fell, apparently because its earnings per share came in one cent short of most analysts' predictions.

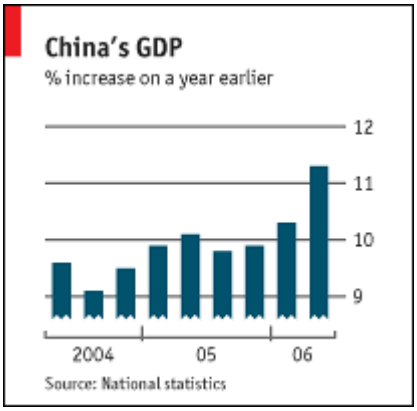
The parent company of the **New York Mercantile Exchange**, which trades in energy and commodity futures, filed preliminary plans for a public offering. Nymex's decision mimics a host of other American exchanges that have decided to end their membership-based ownership structure by launching themselves on the stockmarket.

As Japan exits the deflationary era, its government published an economic report that cautioned the Bank of Japan to be "prudent" about the pace of further **interest-rate** rises because of the fragility of the economic recovery. Last week, the central bank ended its policy of zero interest rates, lifting its key rate to 0.25%. See article

Ben Bernanke's testimony before Congress was interpreted positively by **stockmarkets**—the Dow Jones Industrial Average closed more than 200 points higher—providing some welcome relief. Events in the Middle East caused global markets to fall sharply last week; the **price of oil**, which had surged past $78 a barrel, fell back somewhat. See article

Good for commodities

China's economy grew by 11.3% in the second quarter compared with a year earlier, the fastest rate of growth in a decade. With a bonanza in exports, economists warned that Beijing needs to do more to ensure against an overcapacity in manufacturing. See article



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Israel and Lebanon

The accidental war

Jul 20th 2006
From The Economist print edition

A pointless war that no one may have wanted and no one can win. It should stop now

AP

Get article background

THE war that has just erupted apparently without warning between Israel and Lebanon looks miserably familiar. The wanton spilling of blood, the shattering of lives and homes, the flight of refugees: it has all happened in much the same way and just the same places before. In 1982 an Israeli government sent tanks into the heart of Beirut to crush the “state within a state” of Yasser Arafat and his Palestine Liberation Organisation. A quarter of a century later, Israel's air force is pulverising Lebanon in order to crush the state within a state established there by Hizbullah, Lebanon's Iranian-inspired “Party of God”. That earlier war looked at first like a brilliant victory for Israel. Arafat and his men had to be rescued by the Americans and escorted to exile in faraway Tunis. But Israel's joy did not last. The war killed thousands of Palestinian and Lebanese civilians, along with hundreds of Israeli and Syrian soldiers. It brought years of misery to Lebanon—and, of course, no peace in the end to Israel. The likeliest outcome of this war is that the same futile cycle will repeat itself.

Why it started

As in 1982, it started with a pinprick. Then, it was a Palestinian assassination attempt on an Israeli diplomat in London. This time it was the decision of Hizbullah's leader, Sheikh Hassan Nasrallah, to send his fighters on a cross-border raid into Israel on July 12th, where they killed several soldiers and captured two. This was, as Israel complains, an unprovoked attack on its sovereign territory. Israel says the timing—three days before the G8 summit in St Petersburg—was no coincidence, that Iran was using Hizbullah to deflect attention from its fishy nuclear programme. An equally plausible explanation is that the war is the product of a mistake.

In launching his raid Mr Nasrallah was in fact doing nothing new. In recent years, Hizbullah has mounted several similar raids into Israel. It got away with them, even when Israel was led by Ehud Barak and Ariel Sharon, tough prime ministers who had been war heroes too. Their reactions were astonishingly mild. The reason for this, as Mr Nasrallah constantly boasted, was his arsenal of around 12,000 Iranian and Syrian rockets and missiles. With these as a deterrent, Mr Nasrallah felt free to pursue an intermittent cross-border war against his much stronger neighbour, piling up prestige for resisting the Zionist “occupier”—even though, in point of fact, Israel withdrew from all of Lebanon's territory six years ago,

and has a certificate from the United Nations to prove it.

This time, too, Mr Nasrallah may have expected the usual tokenistic response. If so, he miscalculated. Shortly before the Hizbullah raid carried away two Israeli soldiers, the Palestinian Hamas movement had mounted an equally daring raid into Israel from the Gaza Strip (another place from which Israel had completely withdrawn), killing two soldiers and nabbing another. Perhaps precisely because his non-military background required him to look strong, Israel's new prime minister, Ehud Olmert, decided that this double humiliation was more than he could survive or Israel could bear. So he has chosen to go to war (see article).

To much of the world, that looks like a crazily disproportionate response. And so it is, measured against the offence. But measure it against the threat that Israel feels from Hizbullah and it may not be. From that perspective, this war did not spring from nowhere, even if its timing is an accident. The conditions for it have been building, in slow motion, for years.

In the decades since Israel's invasion of 1982, Hizbullah has emerged as the strongest local military force in Lebanon. Since last year, when Lebanese public opinion and forceful diplomacy pushed out the Syrians, it has been the strongest force, period. It certainly cannot be disarmed, as Israel says piously it should be, by the official Lebanese army. And Hizbullah has shown little interest in Security Council Resolution 1559, which calls equally piously for the disbanding of all Lebanon's militias (there is in fact now only one) but suggests no way of enforcing this. Hizbullah is a political party, with representation in Lebanon's parliament and government, but its militia does not take orders from that government. It almost certainly pays more attention to the ideological and tactical advice it receives from Iran, its chief armourer and mentor.

The untidy political arrangements of its neighbour might be of no interest to Israel but for the fact, now being underlined daily in fire, that by giving Hizbullah all those rockets and missiles Iran has transformed a small militia into a strategic threat to the Jewish state. None of the strong states on Israel's border, such as Egypt or Syria, would dare to plaster Israel's towns and cities with rockets. A non-state actor such as Hizbullah, inside a weak state such as Lebanon, is much less easy to deter. Hizbullah retorts that it needed all these weapons as a deterrent of its own. Israel did after all invade Lebanon and occupy bits of it for 22 years. But it was utter hubris for Hizbullah to believe that, with its rockets in reserve, its fighters could keep crossing into Israel with impunity.

How to end it

A war that starts by accident is not necessarily easy to end. This one is what Israelis call a “war of choice”. Mr Olmert did not have to react the way he did. But now that he has, the stakes could hardly be higher for both sides. It is no longer a matter of wounded pride or the fate of the kidnapped soldiers.

If Hizbullah is beaten, it risks losing its position as the strongest power in the fractious Lebanese state, with damaging consequences in the region for its Iranian sponsor and Syrian ally. If Israel falters, many of its people think, the iron wall of military power that has enabled it to win grudging acceptance in the Middle East will have been seriously breached.

It is because the stakes are so high that both sides have rushed so fast up the ladder of escalation. Israel's aim is not just to even the score by hurting Hizbullah and then stopping. Before stopping, it says, it wants to deprive Hizbullah of its power to strike Israel in future. That means destroying Hizbullah's rocket stores even if they are concealed in villages and bombing its command bunkers even if they are located under the crowded residential suburbs of south Beirut. It also means cutting off Hizbullah's resupply, even if the subsequent blockade by land, sea and air brings Lebanon's economy to its knees. If hundreds of civilians are killed, and hundreds of thousands put to flight, so be it: in war, under Israel's philosophy, moderation is imbecility. Hizbullah is no different, and in some ways worse. The “open war” declared by Mr Nasrallah consists chiefly of firing rockets indiscriminately into Israel's towns. Israel says it is killing civilians by accident, but the disparity in firepower means the Lebanese still suffer much more.

This is madness, and it should end. It is madness because the likelihood of Israel achieving the war aims it has set for itself is negligible. However much punishment Mr Olmert inflicts on Hizbullah, he cannot force it to submit in a way that its leaders and followers will perceive as a humiliation. Israel's first invasion of Lebanon turned into its Vietnam. It is plainly unwilling to occupy the place again. But airpower alone will never destroy every last rocket and prevent Hizbullah's fighters from continuing to send them off. No other outside force looks capable of doing the job on Israel's behalf. At present, the

only way to disarm Hizbullah is therefore in the context of an agreement Hizbullah itself can be made to accept.

George Bush is in no rush to rescue Hizbullah. And why, he must wonder, should he? This organisation killed hundreds of American marines in 1983. It is part of an alliance, consisting also of Iran, Syria and Hamas, working against America's interests and friends. Pro-American governments, such as Egypt and Saudi Arabia, bluntly blame Hizbullah for this latest wasteful war. Israel is asking for more time, perhaps another week or two, to complete its demolition of Hizbullah's arsenal and create a new order in Lebanon. Though Condoleezza Rice, Mr Bush's secretary of state, says she is bound for the region, there is no concealing the American temptation to dawdle.

Hurry, please

That is a mistake. Hizbullah cannot be uprooted. It is not going formally to surrender. Its past struggle against Israel has won it the fierce loyalty of many Lebanese Shias, and its present one will add to their number even if it comes off worse. Israel's security will not be enhanced by destroying the rest of Lebanon. By weakening the Lebanese state, and its fragile but well-intentioned government, Israel just weakens the already feeble constraints Lebanon tries to impose on Hizbullah's actions.

What is needed now is a way for both sides to climb down. Israel must get its soldiers back, Hizbullah's departure from the border area and an undertaking that Hizbullah will not attack again. The Lebanese army or a neutral force should then man the border. Hizbullah needs to be given a way to consent to these changes without losing face. Squaring this will take time, ingenuity and the full engagement of the United States. It will not bring peace to the Middle East but it might silence a dangerous new front. America should start its work at once.

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America's nuclear deal with India

From bad to worse

Jul 20th 2006
From The Economist print edition

America's Congress is preparing to say yes. Others should say no

Get article background

THE damage done by George Bush's proposed nuclear deal with India gets worse and worse. Already weakened by the nuclear antics of Iran and North Korea, the web of treaties and controls that seeks to halt the bomb's spread is starting to unravel. Congress, hitherto a staunch defender of the Nuclear Non-Proliferation Treaty (NPT) and all it stands for, is poised to allow America's laws to be amended to accommodate civilian nuclear trade with India, despite that country's bomb-building. There will then be pressure on the Nuclear Suppliers Group (NSG) to carve an India-shaped hole in its global nuclear export restrictions, and on the board of the International Atomic Energy Agency (IAEA) to agree to "India-specific" safeguards on any nuclear materials or technology sold.

The Bush administration defends its India deal as good for combating global warming, good for friendship with the world's biggest democracy and good for jobs in America. All that is debatable (see article). But its claim that the nuclear deal will be a net gain in the fight against proliferation is pure nonsense. The controversial deal is already undermining confidence in the world's anti-nuclear rules. The NPT, which has helped prevent a number of other capable states from going nuclear, and encouraged some which tried (Argentina and Brazil) and others which had succeeded (South Africa) to turn back, rests on a promise: that only those that renounce nuclear weapons qualify for civilian nuclear assistance. India deliberately stayed outside the treaty to build its bombs; America is now offering it nuclear help anyway. That won't encourage others to keep their non-nuclear promises.

Nor has India taken on any meaningful new non-proliferation obligations to lighten the blow to the treaty. The recognised nuclear powers—America, Russia, Britain, France and China—are committed under the NPT to curb their arsenals (four are shrinking, only China's bomb-pile is still growing) on the way to eventual disarmament; the deal with America lets India build as many bombs as it chooses. The five have at least all signed the treaty banning further nuclear tests and have stopped producing more highly enriched uranium and plutonium for weapons; India flatly refuses to do either.

The wrong sort of helping hand

By lifting restrictions on India's ability to buy nuclear technology and fuel from abroad, America will be helping it out of a uranium squeeze: its usable stocks of the enriched stuff (lower enriched for power generation, higher for weapons) have been dwindling fast. If the NSG goes along, and makes an exception to its rule that nuclear exports can go only to countries with all their nuclear facilities under safeguards, India will no longer have to eke out its nuclear materials. It will be able to accelerate its bomb-building while using foreign uranium for power generation. Russia has already jumped the gun, recently supplying fuel to two Indian reactors, citing "safety" concerns. That is disingenuous. A reactor running short of fuel can simply be shut down; Russia wanted to get to the front of the queue for future contracts. China, unhappy at America's India deal, could do the same for Pakistan.

India has agreed to separate its civilian nuclear reactors from its military ones, with IAEA safeguards on the civilian sort. But when the intent is bomb-building (and India has every intention of expanding its arsenal), technologies and skills imported for running "civilian" reactors can just as easily be put to

military use. India used just such technologies and materials for its first nuclear explosion in 1974. Its civilian and military programmes are closely intertwined—which is why none of its uranium-enrichment or plutonium-reprocessing plants, or its planned plutonium-producing fast-breeder reactors, is on its civilian list. It is even pushing for minimal safeguards on reactors designated as civilian, with inspections only when foreign fuel is present.

Aiding India's nuclear weapons programme, as this deal inevitably will, offends the NPT, which bans such help, direct or indirect, to any country not recognised as a nuclear power by the treaty (and India isn't). Congress is anxious about this too, but uses weasel words that are likely to allow the deal to go forward. That leaves the NSG and the board of the IAEA to decide whether to uphold clear anti-nuclear rules, or be complicit in their further unravelling. Plenty of governments involved are unhappy at America's proposed nuclear agreement with India, but wary of offending either party. It is time they found the courage of their anti-proliferation convictions and blocked the deal, before even more damage is done.

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Executive pay

Taking stock of options

Jul 20th 2006
From The Economist print edition

Despite the latest scandals, linking executive pay to share performance is a good idea

Get article background

LIKE the mint wafer that caused Monty Python's bloated, gluttonous Mr Creosote to explode spectacularly, the backdating of share options may prove to be a small, lethal, “just one” last treat for the fat cats of corporate America. Until recently, despite evidence that many of them had done nothing particularly remarkable, the compensation of executives seemed destined to grow ever bigger. The public, including a growing number of shareholders, have howled ever more loudly but seemed powerless to stop it. Now, however, some managers are likely to wind up in jail for paying themselves money that belonged to ordinary shareholders.

On the face of it, the mystery is how anyone saw anything but theft in dishonestly using hindsight to date options so that they secretly rewarded their recipients with an instant gain. Yet, this is the anything-used-to-go world of executive share options. When everyone is doing it, perhaps it hardly seems like a crime. Executives fought for years against changing accounting rules to acknowledge the blindingly obvious fact that options are a cost to the company, like any other form of pay—claiming that this would cripple American entrepreneurship. But reality has a habit of biting back. The appointment last week of a federal task force to investigate the backdating of options in Silicon Valley (see article) makes it likely that, in at least some cases, executives will be charged with a blatant criminal fraud.

Of babies and bathwater

Some executives complain that the backdating scandal is a populist anti-business witch hunt. Certainly, the extent of the criminality has been exaggerated in some parts. The sums at stake are small, at least relative to the high-profile frauds of a few years ago, such as at Enron and WorldCom. It will be a big surprise if criminal charges are brought against executives at the vast majority of the 2,270 firms fingered by one recent academic study—or even at all of the 60-or-so firms now being investigated by the authorities.

The pity is that the abuse of share options may hurt Silicon Valley in ways that the proper accounting for options introduced this year manifestly has not. Dealing with regulatory investigations and a host of class-action lawsuits will probably impose further costs on one of the main victims of backdating, the

shareholders of the companies concerned. Their managers are now likely to be distracted from their chief task of turning a profit. Even so, backdating is a crime and it needs to be punished. The jailing of some culprits would send a powerful message to the rest that they have a duty of care for the money shareholders entrust to them.

But, just as it would be wrong to conclude that all, or even most, executives were culpable, so it would also be wrong to reject equity-based pay for executives just because it has been abused. Before share options became popular in the 1990s, managers paid more attention to empire-building than they did to shareholders' interests. By giving company bosses an incentive to raise the share price, options encourage them to put shareholders first. But, in a scheme designed to stop managers turning situations to their own ends, oddly little thought was given to setting up share-based incentives that they could not exploit.

Since share options have been treated as a cost in company accounts they have become somewhat less popular. In their place is other equity-based compensation, such as grants of restricted stock, that arguably creates incentives more in line with the interests of ordinary shareholders. And, for all its faults, the Sarbanes-Oxley Act has forced managers to disclose the granting of options more quickly—though so far these rules have not been properly enforced.

The Securities and Exchange Commission should go further. As part of the new rules on executive compensation now out for consultation, companies should have to disclose exactly who has been granted what and why as soon as the award is made. Ideally, all granting, exercise, buying and selling of share options, and of shares themselves, should be made public in advance. If that happens, and shareholders can see exactly what's going on, there's a chance that executive pay will start working more as it should: rewarding those who can handsomely, and those who can't poorly.

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About sponsorship

Online gambling

Texas hold 'em

Jul 20th 2006
From The Economist print edition

American attempts to ban online gambling are self-defeating and hypocritical

Superstock

AS SOMEONE paid to have a keen appreciation of risk, David Carruthers must regret his choice of travel agent. The chief executive of BetonSports was flying to Costa Rica, but no sooner had he touched down in Texas to change planes than he was arrested and, later, charged, along with ten of his associates and various companies, with racketeering, fraud and conspiracy. This week the shares in BetonSports and other online gambling companies listed outside America plunged as the suspicion grew that, after years of inaction, prosecutors mean to close the industry down.

Much of Congress is on their side. Last week the House of Representatives voted to make it illegal to settle a bet with a credit card or wire transfer. Although the Senate is unlikely to make the bill law, the message is plain enough: internet gambling is corrupting and illegal and should be stopped.

The congressmen's eagerness to demonstrate their uncompromising moral stance is more ironic than impressive. For the American campaign against internet gambling is tainted by hypocrisy as well as futility.

A black and red case

Gambling is one of the great successes of online commerce. Americans bet nearly $6 billion online last year, Mr Carruthers has estimated—roughly half of the global total and four times as much as in 2001. The card games, bingo and sports hosted safely outside America attract not just hard-bitten punters but also occasional gamblers out for some fun.

Burgeoning popularity might be taken as a measure of online gambling's value; but to legislators it is a symptom of its evil power (see article). Online gambling, critics contend, feeds addiction, corrupts children, wrecks families, bankrolls criminals and launders money. Internet betting on sports is unambiguously illegal and betting on card games probably so. The answer is as clear as the king of spades: shut down the offshore industry that skirts today's rules.

Oddly, given the high moral tone, much of America's offline gaming industry agrees. Cynics suspect that this may be less a consequence of its concern for family values than of initial fears, fading now, that online betting would cannibalise the offline business. After all, one of the joys of online gambling is that you do not have to go to Atlantic City or Las Vegas to play. Industry special pleading helps square

legislators' hostility to online betting with their willingness to allow online state lotteries and online betting on horse racing.

If prohibitionism really is driven by morality, then it is self-defeating. If you want to put the industry in the hands of dodgy dealers registered in Tuvalu or Vanuatu, if you want to guarantee websites without protection for children or restraints on compulsive gamblers, if you want to help money laundering and fraud, then prohibition is the policy for you.

There is an another approach, which has been tested with online sales of alcohol and pornography, and been found broadly to work. Internet gambling operations know more about their punters than casinos do. Owning a credit card is a good proxy for proof of age; each transaction is logged, so companies can tell who is betting excessively or at odd times of the day; they can tell where a computer is, and so abide by state laws. Registered, branded, taxed gambling companies are not perfect protection against the excesses of betting, but they are the best there is.

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Japan's economy

Free at last

Jul 20th 2006
From The Economist print edition

Celebrate Japan's return to monetary normality, but don't forget the need for reform

AT THE end of “Spirited Away”, Hayao Miyazaki's animated masterpiece, ten-year-old Chihiro uses her wits and her courage to escape from a nightmarish world of ogres and witches. Japan enjoyed a similar deliverance last week, when its central bank turned its back on an interest rate of zero for the first time in almost six years. The quarter-point increase marked an end to the rich world's longest economic stagnation since the Great Depression.

Throughout this 15-year ordeal, Japan has struggled with the difficult issue of what to jettison and what to cling on to. On the face of it, it looks as though the nation has preserved much of what made it different: it has, for instance, held on to its preference for consensus and gradual change, to the dominance of the Liberal Democratic Party and to a business culture that shelters jobs. On closer examination, however, it becomes clear that the country has come a long way.

Howl

The economic and human cost of the lost years was huge. Before the 1990 collapse of its property and stockmarket bubbles, Japan was the envy—and the fear—of the West. But the combination of success and cheap capital that fuelled asset prices tempted companies into impetuous investment and ill-judged diversification. They were backed by reckless banks ready to lend to just about anyone with the right calling-card. Complacent and corrupt politicians failed to reform the system. Deflation and financial distress stifled growth. If Japan had grown at its trend rate throughout those years, its economy would now be a quarter bigger in real terms than it is.

That was the price Japan paid for rejecting the “shock therapy” with which America, Sweden and indeed neighbouring South Korea treated their own banking crises. Yet its failure to take radical action does not mean it has remained completely unchanged. Gradually and reluctantly, Japanese commerce has cleaned itself up. The banking regulator has at last forced the country's banks to acknowledge the shocking extent of their dud loans and is now more independent of its charges than it used to be. Companies have unwound most of the cross-shareholdings that sheltered them from the discipline of the capital markets. Though staff jobs in big companies are still for life, there are fewer of them now because flexible temporary employment has caught on, especially among women.

This slow but steady reform is one reason why the economy looks healthier than it has done in a long time. In its latest survey of the Japanese economy this week, the OECD forecast growth of more than

2%. That's hardly stunning (and pales beside China's announcement this week that it grew at an annual rate of 11.3%, its fastest pace for a decade, in the second quarter of this year); but it's respectable and probably conservative (see article).

Yet the job is only half-finished. There is a series of urgent tasks for the country. Monetary policy is at the top of the list. Last time the central bank raised rates, in 2000, a disastrous recession ensued. This time the increase is justified, because the economy is fundamentally stronger; but the bank's inflation range of 0-2% is too wide for comfort in a country still shaking off deflation. It needs to be closer to 2%.

And there is much else to do. At more than 170% of GDP (less on a net basis) government debt is too high. Banks are still banned from dealing in securities, which makes them weaker than they otherwise would be. Foreigners are waiting for Japan to open the market for corporate control by honouring its promise that they will, in effect, be able to issue shares to finance a takeover. There is little competition, and therefore low productivity, in the service sector.

Japan's recovery has been slower and more painful than it need have been; but failure to embrace radicalism in a recession is understandable. Now that the nightmare is over, it is time for the government to show some courage and for reform to pick up speed.

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Police shooting

The buck stops somewhere

Jul 20th 2006
From The Economist print edition

Nobody has been held to account for the de Menezes shooting, and none of the facts published

Rex Features

EXACTLY a year ago, a young Brazilian electrician left home to do a job in North London and ended up dead on the floor of an underground carriage at Stockwell station. It hardly seems possible that neither the family of Jean Charles de Menezes nor the public is much the wiser today as to why and how he came to be killed as a suspected suicide-bomber. But so it is.

Enlightenment is as far off as ever now, thanks to the decision by the Crown Prosecution Service (CPS) this week not to take individual police officers to court for murder or manslaughter but to charge the department as a whole with offences under the health and safety at work laws (see article). The de Menezes family is baffled and angry; the police continue, broadly, with the policies that proved faulty before; and public trust in law enforcement risks being undermined at a time when the strong powers granted to the police to deal with terrorism make that trust especially important.

If governments decide to give the police the right to carry arms, innocent people will occasionally get shot. Dealing with the consequences is difficult. New York City, for example, struggled to bring to some sort of justice those of its finest who killed Amadou Diallo in 1999. And London's Metropolitan Police had more excuse than most for misfiring, in the wake of terrorist attacks that had left 56 people dead. But that does not mean no one should be held to account.

The CPS may well have been correct in reckoning that the evidence did not support prosecution of individual officers, pointing rather to “operational errors” spread over a number of people. Whether the Health and Safety at Work Act, applied here for the first time to a police shooting, is an appropriate legal framework instead is another matter, smacking as it does more of canteen inspections than of seven shots deliberately pumped into a man's head. An amended version of the government's long-delayed bill on corporate manslaughter might have come closer to the mark.

A prosecution under the health and safety act might reveal some interesting information—more, possibly, than is in the still-unpublished report by the Independent Police Complaints Commission (IPCC) which was handed over to the crown prosecutors in January. That is its only virtue. Such a prosecution will hold no individual to account. Even if the Met lost such a case no one—not even the commissioner of police, Sir Ian Blair, whose “office” has been charged—will stand directly condemned. Any fine imposed will be no more than a transfer of taxpayers' money from one government body to another. Worst of all, the trial seems bound to delay further, for perhaps another year, publication of the IPCC report.

Room at the top

It is wrong that the facts leading to an innocent man's death at the hands of the police remain obscure a year on. It does not serve the public's interests: until those facts are known, it is unlikely that the police will improve substantially the procedures that led them to kill Mr de Menezes. It does not serve the police's interests: while people are left in the dark, they will remain suspicious that there is a cover-up. And it does not serve Sir Ian either: the longer the episode remains unexplained, the less tenable his position becomes. It may be that the facts of the case exonerate him. It may be that they do not. But until they are known, he will be held responsible.

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On Pakistan, iTunes, logistics, Nigeria, the pursuit of happiness

Jul 20th 2006
From The Economist print edition

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Pakistan's problems

SIR – Both your leader on and survey of Pakistan were unduly harsh and unfair to the country, its leadership and its people, to say the least ("The trouble with Pakistan", July 8th; A survey of Pakistan, July 8th). The contention that Pakistan is not doing enough in the campaign against terrorism and extremism is contrary to the facts, which include 700 al-Qaeda operatives captured (including important targets, such as Khalid Sheikh Mohammed), 90,000 Pakistani troops deployed along the border with Afghanistan, and continuing operations in the tribal areas.

For further evidence, one could point to a ban on militant groups, the crackdown on hate literature and the registration and reform of *madrassas*. For you to think that the witches' brew of problems left behind after the Soviet occupation of Afghanistan are amenable to a quick fix shows a lack of comprehension about the complexity of the challenges.

Furthermore, sweeping statements such as "Osama bin Laden is widely believed to be in Pakistan" (believed by whom?), and baseless presumptions such as that President Pervez Musharraf's supporters will "rig" the next national election, bring no credit to *The Economist*. You did not cite the giant strides Pakistan has made in trying to empower women, open up the electronic media and create more press and cultural freedoms. These actions have strengthened civil society and reinforce Pakistan's democratisation process.

Imran Gardezi
High Commission for Pakistan
London

Music appreciation

SIR – In your efforts to illuminate France's decision to open Apple's iTunes online music store to competition, you neglected to mention that the songs bought through iTunes can actually be burned onto blank CDs (Economics focus, July 8th). These can then be played on any CD player and transferred to a digital audio-player from a computer.

Kawika Holbrook
Campbell, California

Moving on

SIR – Your survey of logistics listened to companies with everything to gain from current models of supply chains, such as Dell, Cisco, Boeing, FedEx and DHL (June 17th). But companies like these have an excess of commercial power in their particular supply chain that shifts business risks, like the non-availability of goods on a production line, to a supplier without shifting the associated profit. For example, market leaders, such as Dell, can ask suppliers to provide goods at delivery times measured in days and under conditions that ensure the suppliers must accept the return of unused products. However, the goods supplied take months to manufacture and originate from factories that will consider returns only if the goods are faulty. The companies that survive and prosper under these extreme conditions (they know that they can be replaced in the blink of an eye) certainly will not pay consultants to lecture them about "partnerships".

Tim Morris
Managing director

Easby Electronics
Richmond, North Yorkshire

SIR – You stated that Frederick Smith, FedEx's chief executive, pioneered the air-express business in the early 1970s by delivering parcels to a handful of American cities overnight using Falcon aircraft. As a retired manager for UPS I feel compelled to add that Jim Casey, UPS's founder, decided that a coast-to-coast service was needed as far back as 1927. The company, very small at the time, used scheduled airlines to fly a few packages each day. The need was somewhat limited in the early days and the 1929 stockmarket crash caused the demise of the service. However, in 1956 it was resurrected as a two-day service called Blue Label Air and continues to this day, along with a host of other time-sensitive options.

Chris Boone
Anchorage, Kentucky

SIR – The “bull-whip effect” is a well-known phenomenon in supply-chain management, but it was not invented by Stanford's Hau Lee. The essentials of the model, that system dynamics, in reacting to small changes in demand, have a huge detrimental impact on capacity levels, were introduced by Jay Forrester at the Massachusetts Institute of Technology in the 1960s.

André Maron
Kloten, Switzerland

SIR – The fact that the cost of logistics has fallen as a percentage of America's GDP over the past 25 years is not just because distribution systems have become more efficient. Another significant factor is offshoring, which has reduced the volume of parts moved in and out and around the United States.

Marc Haugen
Hillsborough, California

Transparent action

SIR – Your article on ministerial changes in Nigeria does less than justice to the enormous changes introduced in that country to deal with greater transparency in financial matters and the establishment of institutions to deal with money-laundering and law enforcement (“The lady was for moving”, July 8th).

Since 2001, Nigeria has been on a list of non-co-operating states identified by the Paris-based Financial Action Task Force, of which I was recently president. The task force has been reviewing the situation every year to determine whether Nigeria has made the kind of changes needed to remove it from the list and has worked with President Olusegun Obasanjo and a range of officials in Nigeria. Last month, the country was removed from the list as the Nigerian government has made substantial progress in implementing measures to fight money-laundering and has built a sustainable anti-money-laundering regime.

Kader Asmal, MP
President, Financial Action Task Force, 2005-06
Cape Town

The root of happiness

SIR – While I do appreciate Lexington's interesting perspective brought forth in his analysis of the pursuit of happiness, I would respectfully submit that it was John Locke, not Adam Smith, who influenced Thomas Jefferson when he started to write the Declaration of Independence (July 1st). In 1690 John Locke wrote that men had the natural rights of “life, liberty, and estate”. Adam Smith's career as a published author did not begin until 1759.

Amy Atchison
Flower Mound, Texas

SIR – The “pursuit of happiness” is an absurd term as it is logically impossible to pursue happiness, or

chance. The source of the term, however, is British. In Samuel Johnson's fictional “The History of Rasselas, Prince of Abissinia”, the character Nekayah asks:

> “What...is to be expected from our pursuit of happiness, when we find the state of life to be such that happiness itself is the cause of misery? Why should we endeavour to attain that of which the possession cannot be secured?”

Earlier, the wise man Imlac, a proto-American I suppose, gives the advice:

> “Do not suffer life to stagnate: it will grow muddy for want of motion; commit yourself to the current of the world.”

Anthony Inquemani
Red Hook, New York

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The crisis in Lebanon, Israel and Palestine

Ending will be harder

Jul 20th 2006 | BEIRUT, CAIRO, JERUSALEM AND TEHRAN
From The Economist print edition

AP

How Israel's latest two-fronted war, in Lebanon and Gaza, started—and why it may not finish soon

Get article background

THE hawks in Israel always called it madness, and now they say they have been proved right. When Ehud Barak pulled Israel's army out of its self-declared “security zone” in Lebanon six years ago, and again last summer when Ariel Sharon evacuated all Israel's soldiers and settlers from the Gaza Strip, security types predicted trouble. Land for peace was one thing, they said; land with no peace agreement in return was going to be a mistake.

Messrs Sharon and Barak, both of them former generals, were more relaxed. A unilateral withdrawal would not bring formal peace, but it could at least bring calm. With the occupations of Lebanon and Gaza over, why should the residents of either place continue to fight Israel? And besides, if they did, Israel could always go back in and wallop them again.

It was a fine theory, and for a time it even worked. But now it has collapsed in flames. Israel is at war on both fronts. It is fighting a small dirty war in Gaza and a big, destructive, high-tech war over the skies and off the coast of Lebanon. It is hard to say whose fate is more miserable: a Lebanese caught in the wrong place—in the Shia Muslim suburbs of southern Beirut, in the port city of Tyre, and in any of the Shia villages near the border with Israel—or a Palestinian in Gaza's refugee camps and slums. Both lots are now being pummelled relentlessly by the Israelis.

On each of these fronts the fighting was precipitated by an audacious attack on Israel's army by fighters belonging to extreme Islamist groups that combine the functions of armed militias—“terrorists”, says Israel—and elected political parties.

At the end of June members of the Palestinian Hamas movement tunnelled into Israel, killed two soldiers and abducted a third, Corporal Gilad Shalit. His captors said they would trade him for Palestinian prisoners held in Israel. Ehud Olmert, Israel's new prime minister, refused. Instead, Israel's army went rolling back into the territory from which it had forcibly evicted Israel's settlers less than a year ago.

In its subsequent operations, at least 100 Palestinians, a good half of them civilians, have been killed. The Gazans are in effect under siege, with intermittent water and electricity and patchy supplies of medicine and food. A third of the Palestinian government, led by the Islamists of Hamas, has been put behind bars, while another third is in hiding. Israel is also hitting militants in the West Bank, the bigger part of a would-be Palestinian state; on July 19th it killed ten Palestinians there.

On July 12th it was the turn of Hizbullah, the Iranian-inspired “Party of God” that has controlled Lebanon's border with Israel since pushing out the Israelis, after a long guerrilla war, six years ago. Its attack was even more successful than the capture of Corporal Shalit. The Hizbullah men crossed the border, knocked out two Israeli Humvees, and abducted two soldiers. When the Israelis went in hot pursuit, Hizbullah destroyed one of their tanks with a vast mine—and then fired on the tank's would-be rescuers. In all, eight Israeli soldiers died. Hizbullah's exulting leader, Sheikh Hassan Nasrallah, went on television to taunt Mr Olmert. Hizbullah did not seek escalation, he said, but if Israel chose confrontation, “We are ready.”

Bombs fall on Lebanon

Did Mr Nasrallah intend to provoke a powerful reaction? Or did he expect Mr Olmert to follow the example of Mr Barak and Mr Sharon, who had reacted mildly to similar Hizbullah attacks in the past?

If Hizbullah intended to provoke a war, it has got what it was looking for. As in Gaza, so in Lebanon: Mr Olmert refused flat to bargain for the release of the captured soldiers and decided instead on military action. But on the Lebanese front Israel has embarked on something much bigger than in Gaza. It has set out to destroy Hizbullah's military power, force it away from its border and secure the unconditional return of its prisoners.

Israel's first move was to impose an air and naval blockade on Lebanon. It cratered the runways of Beirut's international airport and began to implement a methodical, violent plan to pound Hizbullah's headquarters, kill its leadership, destroy its huge arsenal of Syrian and Iranian rockets and missiles, and knock out roads and bridges to prevent Hizbullah's friends from sending in new supplies.

Most of the attacks have concentrated on Hizbullah's strongholds in the Shia suburbs of Beirut and in the south. For the most part, Christian areas and the Lebanese army have been spared—but not entirely. Some mainly Christian places—such as Beirut's Ashrafiyeh district and the town of Byblos—have been hit as well.

The Lebanese death toll has been mounting fast: at least 300 people have been killed, most of them civilians. At least 400,000 people, mainly in the Shia-inhabited south, have fled. Tens of thousands of foreigners are being evacuated, mainly by boat; just as many Lebanese, especially better-off middle-class ones, have gone by land to Syria next door, along with Gulf Arab tourists who had come to get away from the broiling heat back home.

The mood across Lebanon is bleak, as people recall Israel's siege of Beirut 24 years ago. They fear that their hopeful but fragile coalition government, led by Fuad Siniora, may collapse, giving way to a renewal of the sectarian tensions that led to a dreadful civil war between 1975 and 1990, which in turn led to a venal Syrian overlordship that ended only a year ago.

Rockets rain on Israel

Hizbullah has a militia. Israel, as Mr Sharon once said, is a regional superpower. Yet this war, though asymmetrical, is by no means one-sided. When the fighting began, Hizbullah probably had at least 12,000 rockets and missiles. According to *Jane's Defence Weekly*, the bulk of these are Katyusha rockets. Though inaccurate, some have a range of 11km (7 miles), while others can fly 26km. Israel says Hizbullah also has Iranian-made Fajr-3 and Fajr-5 rockets, with a range of 45km and 70km. Most worryingly for Israel are the Iranian Zelzal-2 ballistic missiles with warheads weighing 600 kilos, which could carry chemical or biological agents 200km, putting all Israel's big towns at risk.

The Katyusha rockets are small, mobile and easy to hide. Israel accuses Hizbullah of concealing them in people's homes. Hunting them down with artillery and aircraft takes time. After eight days of fighting, Hizbullah was still launching salvoes of them at towns and cities all over northern Israel, with no sign of

slowing down. Even Haifa, Israel's third city (and one with a large Arab population), has come under repeated fire. Eight Israeli rail workers were killed in one attack there. Israelis know that Hizbullah has more lethal missiles in reserve—and that Tel Aviv itself could become a target at any moment.

And yet Israel's mood, in contrast to Lebanon's, is remarkably upbeat. This is not only because Israel's casualties have been, at the very most, a tenth of those of the Palestinians and Lebanese. A determined Israeli patriotism persists. Rather than reassuring people, politicians are warning them to expect a long campaign. An opinion poll this week found that 81% of Israelis wanted the attack on Lebanon to continue, and 58% for it to go on until Hizbullah was wiped out. “Our enemies misinterpreted our willingness to exercise restraint as a sign of weakness,” Mr Olmert told the Knesset, Israel's parliament. “They were wrong.”

This fighting mood marks a shift in Israeli strategy. Hizbullah's defiant presence on the border, its pale yellow flags fluttering in sight of Israeli posts, have undoubtedly rankled with the army and public. Its declared aim—the complete elimination of the Zionist enemy—hardly makes it a congenial neighbour in Israeli eyes. Since Mr Barak took the last Israeli troops out of Lebanon in 2000, Hizbullah has launched cross-border forays, twice kidnapped soldiers, killed about a dozen other soldiers and some six civilians (before this month's violence), and funnelled arms to Palestinians in the West Bank. Yet despite all of this, Israel kept its responses muted, partly to avoid opening a second front when it was busy fighting the Palestinians' *intifada* in the West Bank and Gaza. Mr Sharon, of all people, even agreed to a lopsided prisoner swap in 2004.

So why the sudden change in the manner of Israel's response to these provocations? One reason is military. As the size of Hizbullah's rocket arsenal has grown, so has the conviction of Israel's generals that this was turning into a strategic threat that would have to be removed at some time. Preferably, though, this would have been at a time of Israel's choosing, not Hizbullah's. “It was clear we couldn't live with the missiles,” says Zvi Shtauber, head of the Jaffee Centre for Strategic Studies in Tel Aviv, and a former head of strategic planning for Israel's armed forces. “The question was when to do it.”

The main reason for Mr Olmert's dramatic reaction, however, was political. He and his defence minister, Amir Peretz, are not ex-generals like their predecessors. They need to establish their credibility as men who understand security. The double humiliation of the Hamas and Hizbullah raids from Gaza and Lebanon could have brought a swift end to their government. Moreover, they were elected on the platform of a plan to withdraw—unilaterally once again—from most of the Jewish settlements in the West Bank. The Palestinian and Lebanese raids from the two areas Israel had previously left unilaterally may well have killed this plan for good, unless the army shows that it can suppress military threats from territories Israel has left.

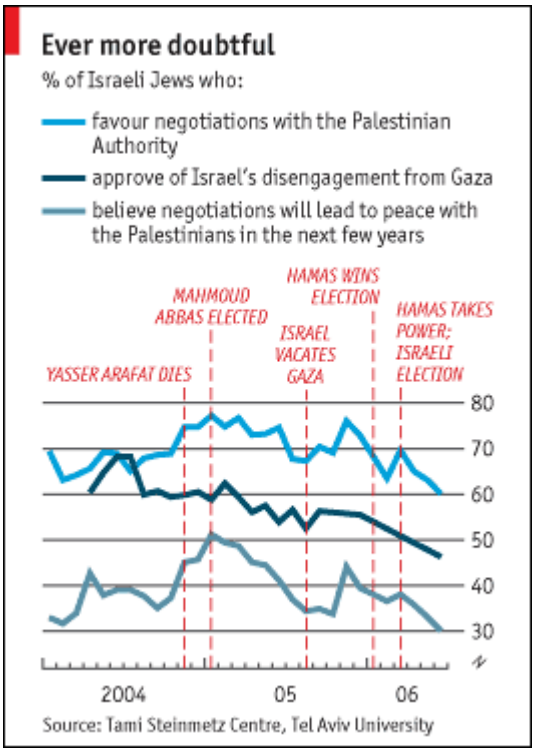
The Israeli army says it is confident of victory. By July 19th, the army said, it had knocked out nearly half

of Hizbullah's rockets and some 180 launch sites. Small numbers of ground troops were going in to pick off Hizbullah posts near the border. Israel's generals and politicians let it be known this week that they wanted another 10-14 days to finish the job.

Even if there were a truce, on something like Israel's terms, how long would it hold? On a deeper level, Israel is confronting the problem of how to adapt an old and familiar military doctrine to changing times. That doctrine is deterrence. Israel's early wars—in 1948, 1956, 1967 and 1973—were waged to repel threats to its very existence, from neighbouring countries with massive armies. Big armies can wipe you out, but they are easy to find, easy to distinguish, and you know when you have beaten them.

But in the occupied Palestinian territories and in Lebanon, which Israel invaded in 1982 to root out the Palestine Liberation Organisation (PLO), because it had taken control of south Lebanon much as Hizbullah has done more recently, Israel's chief enemies have been fighters living among civilians: ideologically driven, easy to replenish, hard to target. And since they never pose an immediate existential threat, it is harder to justify using massive force to wipe them out.

So, during the *intifada*, Israel's army developed techniques for low-intensity conflict—chiefly, tighter links between intelligence-gatherers and the forces in the field. It concluded that one of the most effective tactics against terrorist and guerrilla groups is to kill their leaders; assassinations, relying heavily on intelligence, became a mainstay. Army types often claim that when most of the Palestinian militant groups declared a ceasefire early last year, in a deal with Mahmoud Abbas, the Palestinian president, it was partly because they wanted to take the heat off themselves—and their ever-vulnerable leaders.



When Israel left Gaza, Hamas maintained this ceasefire. Deterrence seemed to be working. But not well enough: Hamas did nothing to stop a smaller group, Islamic Jihad, from continuing to launch a trickle of rockets from Gaza into the towns of southern Israel. Israel's attempts to stop this fire eventually triggered the cycle of raids that led to Corporal Shalit's capture and Mr Olmert's new policy: a big army incursion. The motive, he said recently, was that "at the end of the day, the dominant forces in the Palestinian community will impose the cessation of these violent actions." In other words, hit the Gazans hard enough, and common sense will take over.

And indeed the Gazans are being hit hard. But there are two problems with the deterrence doctrine. First, it assumes that there is such a thing as a dominant force that can take over. In fact Palestinian political and militant groups are so fragmented, thanks in no small part to Israel's attempts to break them, that the chance of any of them imposing their will on the others is slight and dwindling.

Second, the psychology is questionable. A poll by the Jerusalem Media and Communications Centre, a Palestinian research body, found that 77% of Palestinians in the West Bank and Gaza supported Corporal Shalit's abduction; 67% thought that such tactics should be used more, even though only 37% thought that Palestinians would gain as a result, whereas 47% thought they would lose out. The actual result of Israeli policy seems to be: hit Gazans hard and they only get angrier. Exactly the same thing could well happen as a result of Israel's attacks in Lebanon.

All the same, Mr Nasrallah is running an extraordinary risk. He is widely admired for his shrewdness by both Shias and Sunnis, in Lebanon and the wider region. But there are many who are beginning to say that it was reckless of him to have provoked Israel into a new war just when Lebanon was rebuilding its economy, politics and independence in the wake of Syria's departure a year ago. It may be that all his new weaponry went to Mr Nasrallah's head. He certainly bragged about it a lot. But what if Israel succeeds in knocking much of this hardware out? Why did he gamble on war now?

Players and proxies

One possibility is that he did not intend to do any such thing, and that Mr Olmert's robust response to

Hizbullah's cross-border raid took Mr Nasrallah by surprise. Another theory is that he did intend to provoke a war, but not for his own movement's sake. He may have been acting in the interests of Iran and Syria.

That is what America and Israel say they believe. George Bush said this week that Syria wanted to overthrow the pro-Western, anti-Syrian coalition government in Lebanon. Syria's president, Bashar Assad, he implied, could stop the violence with a click of his fingers. Mr Olmert, meanwhile, accused Iran of instructing Mr Nasrallah to start a war to distract world attention from Iran's apparent effort to flout the Nuclear Non-Proliferation Treaty and build a nuclear bomb.

It is almost certainly not so simple. It is clear that Hizbullah depends heavily on both those countries for its moral and logistical support; Iran, not Syria, is its chief mentor. It is also true that Iran and Syria, and Hamas and Hizbullah, have lately drawn closer in an anti-American front across the region. But Hizbullah's relationship with the ruling mullahs is not a simple client-patron one. Hizbullah's leadership has a lot of autonomy in making decisions. Iran may oversee strategy, but Hizbullah works out tactics.

In any event, Iran sounds well pleased with the current rumpus. The more Israel and America blame it for goading on Hamas and Hizbullah, and the more insistently they accuse Iran's munitions experts of giving Hizbullah advice, the more proudly Iran struts the regional stage.

Yet in Tehran it is not clear who is calling the shots in Lebanon, let alone Gaza. It is unlikely that Hamas and its Sunni Arab leaders are—as John Bolton, the American ambassador to the UN, claims—a proxy for the Shia Persians who dominate Iran. And few people in Iran think that relations between Mr Nasrallah and Iran's supreme leader, Ayatollah Ali Khamenei, can be reduced to those of client and boss.

For sure, Iran is widely assumed to be bankrolling Hizbullah and to have supplied many of the rockets and missiles that have fallen on Israel—and on an Israeli ship—since the fighting started, though the Iranians implausibly say they give Hizbullah only humanitarian aid. Furthermore, by asserting that Hizbullah will never lay down its arms, Mr Khamenei has strengthened the impression that he does influence the Lebanese group. Indeed, the Iranian government likes to portray itself as the leader of a regional coalition.

Since the latest round of war began, Iran's president, Mahmoud Ahmadinejad, has talked of “numerous peoples' groups”, by which he means suicide-bombers, in various Muslim countries, waiting to be unleashed on Israel. He has promised to help Iran's longstanding regional ally, Syria, if it comes under attack. This week an editorial in *Kayhan*, the ruling clerics' favourite newspaper, proclaimed Israel's elimination a “national and religious obligation” for all Muslims, and indirectly called for attacks on Israeli civilians anywhere in the world. One zealous Iranian outfit sent two teams of “martyrdom-seekers” to join the war effort. In return, Hizbullah and Hamas long ago promised to help Iran if it came under attack.

Yet, in reality, Iran is less powerful than such fiery rhetoric suggests. Many of its supposed allies are united by little save their hatred for Israel and America. Even Syria, which Manuchehr Mottaki, the Iranian foreign minister, visited this week, differs sharply with Iran on what is good for their common neighbour, Iraq: Iran is far more sympathetic to the new Shia-dominated government, while Syria hankers after the old domination by its sister Baath party, once run by Saddam Hussein.

Even on Palestine, Iran may be more pragmatic than the Holocaust-denying president, Mr Ahmadinejad, sounds. To end the present crisis, Mr Mottaki proposes a ceasefire and a prisoner swap. Moreover, many leading Iranians have said—despite their president's fiery words—that if a majority of Palestinians were to endorse the idea of two states of Israel and Palestine living side by side in peace, Iran would go along with it.

From Iran's point of view, another big bonus from the conflict is that it gives America and Israel a taste of the response they might expect if they decided to curtail Iran's drive to produce a nuclear fuel cycle by attacking its nuclear sites. And the crisis may indeed have helped Iran, which was expected to be the butt of a UN resolution this week demanding that it stop enriching uranium, by pushing the nuclear question off the world's top agenda.

A hit for Hizbullah in Haifa

Not all Arabs love the sheikh

Hizbullah has not endeared itself to many governments in the region, Syria and Iran apart. Mr Nasrallah says he is not fighting for Lebanon but “for the Islamic nation”. Where, he demanded in a challenge to Arab and Muslim leaders, does the nation stand in this battle? The answer has not, so far, been entirely to his liking. As has happened in past crises, the “nation” has been as weak and divided as Lebanon itself. Its heart—opinion in the much-vaunted “Arab street”—may swell in pride at Hizbullah's derring-do and burn with anger over Israel's punishment of Lebanon. But its mind is not so sure.

Syria's Mr Assad, like his Iranian counterpart, may have enlisted Hizbullah's boldness and Lebanon's agony to burnish his own credentials of defiance. But the leaders of Saudi Arabia, who have some claim to influence among the Sunni Muslims, who make up nearly 90% of the faithful, are less keen on Hizbullah. “There is a difference between legitimate resistance and the reckless adventures undertaken by some Lebanese without reference to the authority of the state itself or co-ordination with any state,” read a recent tart Saudi statement. “This action makes the situation in the whole region dangerous.” Similar huffy critiques came from the leaders of Egypt and Jordan.

These countries' leaders have multiple reasons to dislike Hizbullah. It is a non-state actor that challenges state authority. It has sabotaged the frail vestiges of regional peace, and invited disaster upon Lebanon. It is a Shia party, allied with non-Arab Iran. Worst of all, its action has highlighted the inaction of everyone else, especially in light of the mounting plight of the Palestinians. Arab weakness was on display most tellingly at a recent meeting of the Arab League, which struggled even to begin discussing the eventual possibility of an “emergency summit”. A Jordanian newspaper accused Arab leaders of looking like “nervous schoolgirls”.

Yet, as Lebanese casualties have mounted, it has grown increasingly hard for doubters to get a word in. In a rowdy session of Kuwait's parliament, even liberal MPs felt obliged to proclaim solidarity with Hizbullah. Israel's actions, warned Kuwait's staunchly pro-American speaker, will “turn us all into terrorists”.

Likewise, America's strongest Arab ally, President Hosni Mubarak of Egypt, said that Israel's furious response was recruiting millions of new enemies. Batir Wardun, a Jordanian commentator, said that the leaders of Jordan, Egypt and Saudi Arabia were right to denounce Hizbullah's recklessness and to pursue their own people's self-interest “rather than make them hostage to the fortunes of some Hizbullah-Iranian plan”. Yet the Arab leaders' inability to protect the Lebanese people makes them look impotent on the regional stage and weak at home. The West's apparent indifference to Israel's tactics, says an Egyptian diplomat, tells “all those Lebanese who counted on America and France when they revolted against Syria, what kind of friends are these?” A Saudi cabinet statement told Israeli leaders to understand that destroying the Lebanese economy and terrorising its people would not serve “Israel's future in the region”.

No rush for the stopwatch

If Mr Bush had a choice, he would probably like to give Israel the extra time it says it needs to destroy Hizbullah's military power. A spectacular setback for Syria, Iran and their extremist allies in Hamas and Hizbullah might be just the right tonic for America's own flagging fortunes in the region. But America's Arab and European friends are anxious to bring what they see as a destabilising and destructive war to an early stop. Europe and the United Nations are starting to sketch out the way.

Reuters

Nasrallah keeps smiling, for now

Kofi Annan, the UN's secretary-general, has suggested that a powerful international force might create a buffer zone in southern Lebanon. Israel was at first reluctant—it fears that such a force would inhibit its own actions more than Hizbullah's—but may come round. Such an outcome would at least mean that it had changed the reality on its border with Lebanon, and this could be sold to public opinion at home as a victory. But it would fall short of its main aim, which is to deliver such a blow to Hizbullah that it will not pose a serious military threat again.

At times like this, America is quite good at stalling. Those in the administration who want Hizbullah smashed for good are sceptical about an international force. Mr Bolton notes that there has been a UN “interim” force in southern Lebanon for 28 years. Would a new force be any more effective? Would it be able to disarm Hizbullah and deal with Syria and Iran? And would it undercut UN Resolution 1559, which calls for Lebanon's government to control its own territory and disarm militias such as Hizbullah?

Hizbullah, too, may be in no hurry. Some of its strategists believe that even when it is being battered it is better able to sustain a drawn-out war of attrition than Israel, an affluent society which likes to get its wars over with fast. Israel would, after all, find it hard if not impossible to winkle out every last rocket and martyr. It may be some time before the unhappy people of Lebanon and Israel can emerge from their shelters and pick up the shards of their interrupted lives.

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The baby-boomers retire

Of gambling, grannies and good sense

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From The Economist print edition

Corbis

Nevada is the new hot spot for retirees. America should watch how it copes with the influx, and learn

IN THE film “Mars Attacks”, bug-eyed aliens blow up the Landmark, a casino-hotel in Las Vegas. Viewers are impressed at what they assume are nifty special effects. But the explosion was real. In Las Vegas, fancy hotels are often blown up and replaced with bigger, fancier ones (or, in the Landmark's case, a parking lot). These spectacular bangs are a symptom of a spectacular boom: tourist numbers have nearly doubled since 1990. And spearheading the invasion are not homicidal Martians, but old folk.

Nevada has the fastest-growing elderly population of any state. The number of Americans over 65 rose by 16.8% between 1990 and 2004, slightly slower than the growth of the population as a whole. In Nevada it rose by 100.5% and in Clark County, which includes Las Vegas, it rose by 122%. It is not only old folk who are flocking to the global capital of glitz—a boom attracts migrants of all ages. But several of Nevada's qualities appeal especially to the silver generation. It is sunny, relatively cheap and there is no pesky state income tax.

Many newcomers have sold their homes in California, bought somewhere equally spacious in Nevada and pocketed enough change to fund their retirement, or so they hope. Las Vegas itself has great air links—no excuse for children not to visit—and plenty of jobs for the over-50s.

Most casino work is not physically strenuous. Whatever movies may suggest, employees are rarely called upon to beat people to death and bury them in shallow graves in the desert. Casinos are owned by reputable corporations these days. “It's like working in a bank, but more fun,” says Barbara Kucala, the 52-year-old “director of cage operations” at Caesar's Palace—meaning that she runs a secure cash-counting office, known as “the cage”.

Harrah's, the firm that owns Caesar's Palace, does not keep track of its employees' ages, but a brief walkabout reveals many silver-haired croupiers, waitresses and vendors of Elton John-themed knick-knacks. Most seem happy to be busy. Geri Demeo, for example, a tanned 66-year-old telephonist with golden heels, big ear-rings and spiked blonde hair, says she likes “to get dressed up to come to work”. She also likes her co-workers, the opportunity to learn about computers and the occasional brushes with stars. Retiring completely would be unwise, she says. “You should always do something.”

This is the year the first baby-boomers turn 60, including Presidents George Bush and Bill Clinton. As the boomers age, so will America. For canny marketers, this is an opportunity. An advertisement for Miracle-Ear hearing aids shows a picture of a spaced-out youth, coiffured for Woodstock. “Back then you chose not to listen,” says the caption. Then, above a picture of the same man 40 years on: “Make today the day you choose to hear better.”

At the same time, however, the boomers' ageing will create problems for America. Not as acute as those faced by other rich countries, to be sure—America's high rates of fertility and immigration ensure that its population will age more slowly than say, those of Western Europe or Japan. But someone will still have to pay for all the extra health care and nursing-home beds, and America's system of provision is both costly and dysfunctional.

Deficit hawks fret that the government's three main entitlement programmes—Social Security (pensions), Medicare (health care for the elderly) and Medicaid (health care for the poor and residential care for old people who cannot afford it)—will eventually bankrupt America. Brian Riedl of the Heritage Foundation, a conservative think-tank, predicts that these programmes, if unreformed, will cause federal spending to swell from 20% of GDP today to a peacetime high of 33% by 2050. Paying for this would require huge tax increases, massive deficit spending or the “elimination of every other federal programme”, he reckons.

One answer would be to cut benefits and raise the age at which people first qualify for them. AARP (formerly the American Association of Retired Persons) disagrees. And with 35m dues-paying members, it can deluge with protests any politician who flirts with such notions.

AARP was instrumental in pushing a budget-busting prescription-drug benefit for old people through Congress in 2003. More recently, it helped to block Mr Bush's plan to reform Social Security by allowing people to divert a portion of their Social Security taxes into private accounts. Mr Bush argued that his plan would enable Americans to gain higher returns for their retirement savings. AARP's line is that any private accounts should supplement Social Security, not replace it, even partially.

Its critics say it promotes a vast transfer of wealth from the young to the old, which is unfair since older people are, on average, much richer. But AARP tends to win its battles. Not only is it the largest lobby group, but its members tend to vote more than youngsters. And, unlike other special interests, it represents a group that everyone expects one day to join.

John Rother, AARP's policy director, says the problem is not that old people's benefits are too generous, but that medical inflation is too high and Americans do not save enough for retirement. He has a point; health-care costs jumped 6.8% in 2004, more than twice the general rate of inflation. And Americans' personal-savings rate was minus 1.7% in May; Mr Rother thinks plus 10% would be more prudent.

The world according to AARP

Until recently, AARP argued that economic security for “seniors”, as it calls them, rested on three pillars: Social Security, private pensions and personal savings. Now it adds health insurance and work.

Health insurance is most problematic for those who are not covered by an employer, not quite old enough for Medicare (which typically kicks in at 65) and not quite poor enough for Medicaid. Another problem for the old and infirm is that although the Medicare drug benefit covers the first $2,250 they spend on medicines each year and anything over $5,100, they themselves have to fill the “doughnut hole” between these figures. Most can afford this, but some cannot. Since the benefit is not means-tested, it represents a big handout to millions of well-off people, but fails to cover large numbers of the needy.

Many of the problems caused by the ageing of America would be eased if more old people carried on working. It is one thing to give pensions to 65-year-olds when most people never reach that age, as was true when Social Security began in the 1930s. It is quite another to pay people to retire in their mid-60s when they can expect to live for nearly two more decades, as is true today.

Happily, older Americans are indeed toiling longer. The proportion of 65-69 year olds still working was only 18.4% in 1985, but rose to 28.3% last year. About half of the baby-boomers say they plan to work past 65. However, a study by McKinsey and Co, a consultancy, notes that 40% of current retirees were forced to quit before they wanted to, either because of ill health or because they lost their jobs.

Older workers are sometimes laid off because they have racked up annual pay-rises for decades, their health coverage is expensive and their employers cannot therefore afford to keep them. But if they move to Vegas with a pot of savings and take a part-time job to keep themselves occupied, employers love them. “Older employees have wisdom, temperance and patience. They've seen it all, and they're working because they really want to. So they are great service providers,” says Jan Jones, a vice-president of Harrah's and former mayor of Las Vegas.

When people say America's future will look like Las Vegas, they usually mean there will be fewer jobs in manufacturing and more in services. But the city also provides an example of how (and how not) to cope with the boomers surging past 60.

The casinos are scrambling to compete for the boomers' money: hence the parade of crooners of a certain age and a show called “Menopause—the Musical” at the Hilton. Many boomers retire to Las Vegas because they so enjoyed holidaying there. When they first arrive, they are typically “young-old”, healthy and relatively wealthy. Their spending boosts the local economy, especially if they can afford spa treatments and dog-washing services. But as they age they will start, as a group, to demand more public services.

“Right now they are not costing us much,” says Mary Liveratti, deputy director of Nevada's Department of Health and Human Services. “But look at Arizona [a long-time magnet for the retired]. Twenty years ago it was great. But now they need lots of hospitals.”

Equally important, they need long-term care. If they are well-off and inclined to plan ahead, they can enter somewhere like Las Ventanas, a “continuing care retirement community” in Las Vegas. That means you move in while still “active” and stay until you die. The apartments are stylish and step-less. As you grow frailer, you can move to an apartment with more hands-on care, but in the same complex. You get peace of mind; you won't need to move again, and even if you outlive your savings, Las Ventanas will not throw you out. The only snag is that it costs at least $200,000 to join (mostly refundable if you move out) and the rent is a hefty $2,200-4,500 a month.

Zimmers in the desert

Elinor Ginzler, a housing specialist at AARP, thinks the market will throw up lots of new living arrangements for retirees soon, because “boomers like choice”. Or as Claudia Collins, a boomer who is a specialist in ageing at the University of Nevada, puts it: “We're going to change everything, because we redefine everything and everything's about us, okay?”

The burden of caring for less prosperous old folk is split between the state and the federal government. For Nevada, this represents a potential fiscal crisis. The state recently raised gaming and sin taxes, but Nevadans remain allergic to income tax. “The tourists come here, pay our taxes and go away again,” says Ms Collins, and that is how the locals like it. Tourists' losses at blackjack help Nevada fill the “doughnut hole” in the Medicare prescription-drug plan, and cover some of the costs of residential care.

Nevada has plenty of spare land, most of it owned by the federal government and long idle bar the occasional nuclear explosion. Harry Reid, a powerful Nevada senator, wangled a free plot near Las Vegas for a non-profit nursing home for the poor called Silver Sky. With seed money from Harrah's, it opened this month. It is less fancy than Las Ventanas, but pleasant and much cheaper—about $1,700 per resident per month, all of which can be covered by Medicaid and Social Security. “It helps that Nevada is the Wild West,” says David Ennis, the developer. “It doesn't have entrenched lobbies. If we'd tried this in Massachusetts, the existing nursing-homes would have tried to stop us.”

If it works, Silver Sky will be copied elsewhere. But it represents a small bite at a huge problem. It is tough to make long-term plans in Nevada; the population is fast-growing but transient, and the economy is hyper-sensitive to future changes in other states' gambling laws. Forecasts a decade ahead are no likelier to be accurate than a bet on a horse.

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Cotton

A tangle of troubles

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From The Economist print edition

America's cotton-farmers are worried about both drought and Doha

“THAT'S what the drought does for us,” says Barry Evans, a family farmer near the west Texas town of Kress. He is peering out of his pickup at thin, scraggly green cotton plants, a foot or so high in between rows of dry stalks. It barely rained last winter and, by June, Kress had received less than two-thirds of the rain that fell a year earlier. Now blistering heat is drying out the plants even more. Across the Texas plains, cotton experts estimate that 1m acres—perhaps 15% of the state's crop—have already been lost.

If weather were the only problem facing cotton farmers, things might not be so bad. They are used to nature's whims: Kress lies in the heart of the 1930s Dust Bowl, and even today dirt storms (and sometimes tornadoes) roll through in the spring. Fortunately cotton requires much less water than, say, maize. Many farmers tap the Ogallala Aquifer for at least part of their crop, but Texas also has substantial areas of “dry-land cotton” (about one-third of Mr Evans's crop, for example) that remain outside the irrigators' reach.

Free trade is even more of a threat. The cotton industry exists in America only because of subsidies, and it stands to lose much if the World Trade Organisation's Doha negotiating round succeeds. Cutting trade-distorting farm subsidies is a top priority in the trade round and negotiators have already promised that subsidies for cotton will be cut “more ambitiously” than others.

Nothing will happen immediately, since the talks are at a standstill. American negotiators have offered to cut the limits for the most trade-skewing subsidies by 60% in return for greater access to international markets. The European Union and big developing countries want bigger cuts in America's subsidies but are loth, as always, to dismantle their own barriers.

The absurdity of America's cotton subsidies is well known. Uncle Sam spends over $4 billion a year propping up cotton farmers, with the bulk of the money going to those whose operations are much larger than Mr Evans's. Cotton receives far more government cash per acre than other crops—in 2001, four or five times that of maize or wheat, according to a recent paper by the National Centre for Policy Analysis, a conservative think-tank. The losers are not just American taxpayers but some of the world's poorest farmers, as America's subsidised production pushes down world prices. Cotton prices have halved since the mid-1990s as America's subsidies have doubled.

The end of this gravy train is long overdue. Some change is inevitable even without a Doha deal, as the WTO has already declared some American cotton subsidies illegal. The uncertainly is casting a pall over the Cotton Belt—especially Texas, where more than a third of America's 20m bales are grown. Mr Evans, looking gloomily ahead, fears his livelihood may be about to be “traded away”.

Don Ethridge, director of the Cotton Economics Research Institute at Texas Tech University, reckons that if America cuts its cotton subsidy by 60%, income for cotton farmers would fall by 26% over six years—or 19% if America won great access to international markets. “We're scared to death,” says Mr Evans. Though not scared enough, it seems, to think beyond today's subsidies. Some dream that cottonseed oil, already used for cooking, could one day power America's cars. But “I sure am not going to bet my long-term future on biofuels,” says Mr Evans. “We just don't know enough yet.”

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Stem-cell research

Mr Bush's first veto

Jul 20th 2006 | WASHINGTON, DC
From The Economist print edition

Principled, but wrong

Get article background

FIVE and a half years into his presidency, George Bush finally vetoed a bill this week. Oddly enough, it was one that most Americans support: it would have expanded federal funding for embryonic stem-cell research. The House and Senate had both passed the bill by wide, but not veto-proof margins, so Mr Bush's word is final, at least until after the mid-term elections in November.

Stem cells are cells that have not yet decided what they want to be when they grow up. That is, they can become blood cells, brain cells, or pretty much any other type of cell. Their versatility makes them extremely useful for medical research. The ethical snag is that the best stem cells are harvested from human embryos, killing them. For the most ardent pro-lifers, including Mr Bush and many of his core supporters, that is murder. Proponents of embryonic stem-cell research point out that hordes of embryos are created during fertility treatment, and the vast majority of these are either frozen indefinitely or destroyed. Is it really wrong to use them for potentially life-saving research? Yes, said Mr Bush on July 19th, flanked by some families who had “adopted” other people's frozen embryos and used them to have children of their own.

Mr Bush's veto does not kill stem-cell research. Scientists who spurn federal cash may do as they please. The government still pays for research on stem cells taken from adults, a process that does not kill the donor. And a decision by Mr Bush in 2001 allows federally-funded scientists to experiment on the few dozen embryonic stem-cell “lines” that already existed then, which can be propagated in a laboratory.

Nonetheless, scientists are furious with Mr Bush. Federal funding would surely push them faster towards those elusive cures. Research based on adult stem cells may be promising, but not nearly as promising as that based on embryonic ones. There are worries that those few dozen embryonic stem-cell lines represent too narrow a gene pool, and that they cannot be endlessly extended without damaging them. Other countries, such as Britain and China, are enthusiastically experimenting on embryonic stem cells. But the world's most innovative nation is hanging back.

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Executions

A doctors' revolt

Jul 20th 2006 | ST LOUIS
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How regulation may eventually make death too hard to administer

ANN HARRISON was 15 years old when she was raped and murdered near Kansas City, Missouri, in 1989. Michael Taylor and another man abducted her as she waited for the school bus outside her house. After stabbing her repeatedly, they left her to die in the boot of a car.

Mr Taylor was sentenced to death by lethal injection, the normal method now in all but one of the 38 states that allow capital punishment. He was hours away from the needle last month when a federal court of appeals stopped the execution to consider whether lethal injection is cruel and unusual punishment under the eighth amendment to the constitution.

The process is a three-stage one. The condemned person is first injected with an anaesthetic to put him in a deep sleep. A second drug paralyses his muscles and the third, potassium chloride, stops his heart. Mr Taylor's lawyers argued that this process could inflict great pain on their client before it killed him. An article last year in the *Lancet*, a British medical journal, lends fuel to their argument. Autopsies of criminals from four states showed that 88% had been given inadequate levels of anaesthetic. The authors went on to condemn “medical collusion” in the death penalty as “an American atrocity”.

The pain caused by lethal injections, if anaesthesia is not properly administered, has been an issue for some time. Earlier this year, federal courts in California examined execution logs to determine whether the inmates had been awake during the final stage. A judge subsequently ruled that qualified people must be present—closely present, not merely watching from outside—to monitor executions. The immediate result was that the execution of one killer was postponed because two anaesthesiologists, hired to monitor his death, had second thoughts.

The Missouri case takes the saga further. Fernando Gaitan, a federal judge in Kansas City, cross-examined the surgeon—identified only as “John Doe 1”—who supervises the state's executions. Dr Doe, as it happens, is dyslexic, and admitted that he often transposes numbers. He also admitted that he had prepared a dose of anaesthetic of only half the recommended strength in a previous execution, and had prepared the same dose for Mr Taylor.

The judge ruled that the state must employ a board-certified anaesthesiologist and maintain operating-room standards in the execution chamber. He also ruled that the doctor had to be present, preferably in the chamber itself, to monitor the procedure. State authorities were given until July 15th to submit revised execution procedures to the court for review.

Predictably, they missed the deadline. The Department of Corrections contacted 298 anaesthesiologists in Missouri and southern Illinois, without receiving a reply. Nor is it likely to get one. Orin Guidry, the president of the American Society of Anaesthesiologists, has clearly warned doctors against involvement in capital punishment. “Steer clear,” he told the society's members. “Physicians are healers, not executioners...The legal system has painted itself into this corner and it is not our obligation to get it out.” The American Medical Association's code of ethics forbids doctors to take part.

Several states, their executions on hold, are now awaiting the Supreme Court's decision in the case of Clarence Hill, convicted of murdering a policeman in Florida in 1982. Mr Hill had already been strapped to the gurney when the Supreme Court dramatically stopped his execution last January, saying it would hear his claim that he should have a chance to argue that lethal injection, if excessively painful, violated his constitutional rights. Last month, the court rejected an Arkansas request to void a lower court's stay of execution of Don Davis, on similar grounds.

States are rushing to devise new, less painful chemical formulas and procedures to use in executions. Missouri has begged the judge to be allowed to continue, and has promised to use stronger doses of the knockout drug. But amid mounting domestic and international criticism of the death penalty, some are wondering whether it may at last be on its way out.

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The Georgia primary

Broken Reed

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A golden boy of the religious right comes a cropper

IN 1995, *Time* magazine called Ralph Reed, then 33, “The right hand of God”. But perhaps God is left-handed. Mr Reed ran this year for lieutenant-governor of Georgia, a middling job widely expected to be a stepping stone to the governorship and possibly national office. Instead, on July 18th, Mr Reed—who, as the former head of the Christian Coalition, had drummed up millions of evangelical votes for the Republican Party in the 1990s—lost his primary race to a little-known Republican challenger.

The tripping-up of Mr Reed, legendary for his fundraising and grass-roots activism, may have national significance. His challenger, Casey Cagle, was an undistinguished state senator. But Mr Reed was tainted by his association with Jack Abramoff, a disgraced Republican lobbyist. Mr Abramoff was hired by Indian tribes with gambling interests to ward off the legalisation of casinos by tribes in neighbouring states. Mr Abramoff in turn hired Mr Reed to lobby against the new casinos. Mr Reed, a religious conservative, campaigned (successfully) against the casinos on moral grounds, calling gambling a “cancer on the American body politic” and a destroyer of families.

AP

Abramoff's a bad guy?

But his pay came from gambling interests themselves, funnelled through third parties. Mr Abramoff went to jail for these and other crimes. Mr Reed has not been charged with any crime, though he faces civil lawsuits from the tribes he defeated. He claimed he did not know where the money came from. But a Senate investigation released e-mails from Mr Abramoff to Mr Reed mentioning one of Abramoff's clients, “the tribe”. Mr Reed has since merely said that if he had known then what he knows now, he wouldn't have taken the work.

Mr Reed's loss by a surprising 12 percentage points is no great win for left-wing America. Mr Cagle is a conservative Republican staunchly opposed to such things as abortion and gay marriage. But it may hint at how large the corruption scandals of recent years could loom in November's elections. Mr Reed, with his handsome young face and formidable reputation, should have glided easily into the sinecure of the lieutenant-governor's job. Instead, Georgia's conservative voters decided that they like their choirboys clean.

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Fires in the West

Hot and hotter

Jul 20th 2006 | SEATTLE
From The Economist print edition

Yet another run of disasters to blame on climate change

FIRE season is well underway, but some blazes get more publicity than others. The two huge fires that torched thousands of acres of forests and sagebrush and nearly destroyed Pioneertown, once a popular backdrop for Westerns, have had banner headlines in the *Los Angeles Times*; but then they were only 100 miles (160 km) east of the city. Montana has had several fires as large, and hardly a squeak has been heard outside Billings.

Over much of the West, in fact, a searing heatwave threatens to turn this summer into a fire season to match the notable scorchers in 1999 and 2003. In Montana the 92,000-acre (38,000 hectares) Bundy Railroad fire forced firefighters to retreat three times in the face of high winds that fanned burning stands of dried grass, sagebrush and ponderosa pines. Heat and wind also fed the flames in the California fires.

So far, fire managers in Boise, Idaho—where the National Interagency Fire Centre acts as sort of a wildland fire Pentagon, dispatching firefighters, fire engines and aircraft to the hottest spots—have held their “readiness measure” at Level 3. At the highest, Level 5, fire crews are stretched to their absolute limit. “So far, we're doing pretty well, given it's as hot as it is,” says Rose Davis at the fire centre. Still, the summer of 2006 has already seen more acres burned than in recent years: 4.4m acres by July 16th, compared with 3.4m acres by the same time last year. And with the hot weather settling in and forests drying out fast, the summer could bring many more large fires. Fifteen new ones were reported on July 18th alone, in Montana, California, Idaho and other states.

The United States spends about $1 billion a year fighting wildland fires, and fire experts have come to agree that they are getting larger, hotter and more destructive. But why? Forestry practices, perhaps, which encourage denser forests in order to extract more timber. Or sheep and cattle, whose grazing reduces the grass that can feed the frequent, low-intensity fires that do many forests good. Even firefighting itself has been blamed: by preventing smaller fires in forests, firemen ensure that, when one starts, it's a monster.

Early in July, a team of scientists writing in *Science* magazine found another culprit: climate change. Since the mid-1980s, the team reported, earlier spring thaws have led to drier forests, which have combined with warmer, drier summers to make fires bigger and more common. Since 1986 the number of fires has increased fourfold, while very large fires of 250,000 acres and more have become more frequent. It now takes much longer, too, to control a large fire, from an average of 7.5 days in the 1970s and early 1980s to 37.1 days today. And the fire season is longer, with fires burning later into the autumn months.

It is no surprise that climate should play a role in forest fires. Indeed, one of the *Science* report's co-authors, Tom Swetnam, a specialist in the study of tree rings at the University of Arizona, has long studied the influence of climate on historical fire patterns. But the *Science* report is the first to make a direct connection between climate change and the compelling, if anecdotal, evidence that fires are changing.

The paper has set off heated discussion among fire experts. Some worry that its emphasis on climate

may lead people to think that little can be done to prevent big fires. And that may be true, confesses Mr Swetnam. But he also agrees that good forest management—thinning overgrown tree stands, or making use of selective fire as a housecleaning tool in the forests—may help tamp down a probable upward trend in the severity of fires.

Easier said than done. Greens often oppose forest thinning as logging in disguise, while state air-quality officials, particularly in California, regularly fight forest managers over permission to start deliberate fires. But fire will have the last word. As Mr Swetnam dryly notes, increasingly common fires over 500,000 acres or more will tend to change the landscape. “Sooner or later, that adds up,” he says.

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Venezuela's opposition

Damned whatever they do

Jul 20th 2006 | CARACAS
From The Economist print edition

The difficulty of standing up to Hugo Chávez in an election that may well not be free or fair

Get article background

EVER since he won a recall referendum in August 2004 and thus escaped being yanked out of the presidency, Hugo Chávez has exercised untrammelled power in Venezuela. The divided and leaderless opposition, by contrast, has toiled in the political wilderness. So Mr Chávez, who was first elected in 1998 and is flush with oil money, ought to have no difficulty securing another six years in office in the presidential election in December. But will the election be either free or fair? The opposition's doubts about that put it in an awkward dilemma.

Mr Chávez, a former army officer, claims to be leading both a leftist-nationalist revolution and a "participatory democracy". In practice his rule is authoritarian in many ways, so it is particularly important for him to show that he commands popular support. In January he kicked off the election year by calling for 10m votes—4m more than he received in the referendum.

That looks a tall order. But on the other hand no one seriously expects Mr Chávez to lose. The opinion polls say he has the backing of about 55% of respondents. That popularity is partly the result of Venezuela's huge windfall from high oil prices, some of which is paying for social programmes and make-work schemes aimed at the poor. But he also benefits from his skill at communicating with voters, and from the low opinion they hold of many opposition leaders, whom they identify with discredited parties of the past.

The opposition claimed, without proof, that Mr Chávez's victory in the recall referendum was fraudulent. Last December many opposition parties pulled out of a legislative election at the last minute, claiming that the National Electoral Council was biased against them. The result was that the National Assembly now lacks even a single opposition representative. It recently chose a new five-member board for the electoral council. The board has a *chavista* majority of four to one. In acting thus, the assembly ignored demands by, among others, a European Union observer mission which called for the council to be clearly independent.

The new council has refused to abandon the use of fingerprinting machines to check voters' identities, which the opposition claims violates the secrecy of the vote. It refuses, too, to count paper ballots as a check on controversial voting machines. It has rejected a plan by a group of independent universities to audit the electoral register. This has expanded by 2m names in the past two years. The opposition suspects it is padded with phoney voters.

So the first decision the opposition faces is whether to take part at all. A vocal minority argues for a boycott—partly because of worries that many opposition voters will anyway shun what they see as a farce. Even opposition politicians who want to take part have warned the electoral council that, if it does not heed their demands for fair play, the president could be left to compete against himself. In response, Mr Chávez has threatened to hold a simultaneous referendum to remove the constitutional limit of two consecutive presidential terms.

Henry Ramos, the leader of Democratic Action, a once-dominant party, who is a leading abstentionist, compares the dozen or so would-be opposition candidates to “drunks fighting over an empty bottle”. Most are political lightweights, but three have some substance: Manuel Rosales, the governor of the populous western state of Zulia; Julio Borges, leader of Justice First, a newish, centre-right party; and Teodoro Petkoff, a guerrilla leader in the 1960s, then a social-democratic planning minister and now a newspaper editor.

All three agree that the opposition's only hope is to unite behind a single candidate. But they disagree about how that person should be chosen. On August 13th most of the hopefuls will take part in a primary organised by Súmate, the opposition's main electoral pressure group.

Mr Petkoff, however, is not taking part. He objects to Súmate's rigid conditions, which included a commitment to pull out of the election in certain circumstances. Súmate's leaders are already being prosecuted by the government for receiving money from the United States Congress. *Chavista* legislators are calling for their arrest, saying they were usurping the electoral council's role by organising the primary. Now Súmate is under fire from some in the opposition too, for taking on a role that ought to be the political parties'—if only they were stronger.

While the opposition continues to squabble, the opinion polls suggest that Venezuelans are hungry for change. Despite Mr Chávez's personal popularity, his government is seen by almost three-quarters of respondents as incompetent and corrupt. A recent poll by one firm, Hinterlaces, found that “someone new” (17%) and “none of the above” (10%) came second and third in the list of voter preferences, well ahead of Mr Rosales (7%), Mr Borges (5%) and Mr Petkoff (4%).

If Mr Chávez is sure to win, why is he not prepared to ensure a free and fair election? Because such a vote might be quite close if turnout is low, says Alfredo Keller, another pollster. He detects mounting apathy among *chavistas*. That is why Mr Chávez might be quite happy with a contest boycotted by most of the opposition. In any event, he claims his real opponent is George Bush. As if to prove the point he set off this week on a world tour to promote Venezuela's bid for a seat on the UN Security Council, taking in Russia and Iran. Perhaps he sees them as model democracies—or perhaps he merely wants to provoke Mr Bush.

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Mexico

Uncivilly resistant

Jul 20th 2006 | MEXICO CITY
From The Economist print edition

The loser looks unlikely ever to concede defeat

Reuters

They think they were robbed

IF THE loser gets his way, the battle for Mexico's presidential election will be settled on the streets. On July 16th, several hundred thousand supporters of Andrés Manuel López Obrador, the left-of-centre candidate, gathered in Mexico City to support their man's claim that he was robbed of victory in the election on July 2nd by fraud, or at least miscounting. He now plans a campaign of “civil resistance”, another big rally on July 30th, and 24-hour vigils at 300 district offices where the ballot boxes are kept under military guard. Yet he risks overplaying his hand.

His disappointment is not hard to understand. Having long led in the opinion polls, the official count found that he had lost the election by 244,000 votes (0.58%) to Felipe Calderón of the ruling National Action Party. In papers filed with the Federal Electoral Tribunal, Mr López Obrador has challenged the count at 50,000 of the 130,000 polling stations. He wants a full recount—something which it is not clear that the tribunal can order.

The tribunal has until September 6th to rule. The challenger has yet to offer Mexicans any convincing evidence of irregularities. His campaign has also undermined its own case by wavering as to whether or not he will accept the tribunal's verdict if it goes against him. Jesús Ortega, one of Mr López Obrador's advisers, has said that even if Mr Calderón were to come out ahead in a recount, his victory would be illegitimate. That is because, Mr Ortega claims, Mexico's president, Vicente Fox, campaigned on Mr Calderón's behalf. This suggests Mr López Obrador's real aim is to have the election annulled, and a new one called.

Yet that might be a step too far even for some of Mr López Obrador's own supporters. Mexico has battled for years to eradicate fraud and to set up independent electoral institutions. The loser has every right to call for the tribunal to investigate any irregularities. But if he refuses to accept its verdict, he will have confirmed the charge that Mr Calderón threw at him during the campaign: that he is not a true believer in democracy and its institutions.

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Canada

Interpreting smoke signals

Jul 20th 2006 | OTTAWA
From The Economist print edition

Having shunned Kyoto, Stephen Harper is searching for a policy on emissions

THE people who run the Montreal Exchange know all about risk. What began life as a market for penny stocks in a mining boom in the 1870s now deals exclusively in derivatives, an asset class known for its volatility. This month, the exchange announced plans to start trading credits for carbon-dioxide emissions, a scheme modelled on the Amsterdam-based European Climate Exchange set up last year. But the government regulations and registry of companies needed to make a climate exchange work do not yet exist in Canada. The exchange's bet is that they will appear this autumn, when Stephen Harper, the prime minister, unveils his promised “made-in-Canada” policy to address climate change.

Mr Harper, who won an election in January, has long argued that Canada could not possibly meet the emissions targets it had agreed to under the Kyoto Protocol. But since taking office, he and his environment minister, Rona Ambrose, have sent out confusing signals about what they intend to do about this. Joining the United States and Australia, fellow Kyoto-doubters, in the rival Asia-Pacific Partnership has been mooted. So has staying within Kyoto. An aide says, vaguely, that the government plans a “holistic” approach that covers air, land and water pollution.

Canada's policy on emissions has long been a shambles. Since the late 1980s, successive governments, Conservative and Liberal, agreed to targets but without the measures required to meet them. The latest was the Kyoto Protocol, which Canada ratified under a Liberal government in 2002. This requires Canada to cut emissions of greenhouse gases to a level 6% below 1990 levels by 2012.

The Liberals spent billions on programmes intended to encourage households and companies to curb their energy use, to little effect. Emissions of greenhouse gases continued to climb—but faster still. The government admits that in 2004 they totalled 758m tonnes—or a third more than the Kyoto target. On present trends, they will be double the target by 2012. To meet it, the government would have to spend billions more buying emission credits from countries such as Russia that have exceeded their goals.

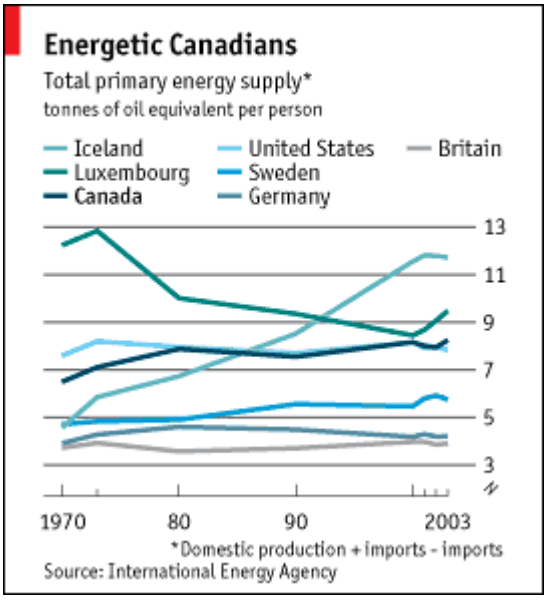
So Mr Harper was merely stating the obvious. But on taking office, he cut several Liberal environmental programmes without putting anything in their place. Coming up with alternatives will not be easy. A wasteful attitude to energy use, business fears of extra costs and the eternal tension between federal and provincial governments all stand in his way.

It doesn't help that global warming sounds like good news in a country of interminable winters. Climate change may be melting the Arctic ice cap, endangering polar bears and the traditional way of life of the Inuit, but most Canadians live far to the south. They tell pollsters they are increasingly worried about the environment. But in practice they are champion energy consumers, outpaced only by Iceland and Luxembourg among rich countries (see chart).

In 2005, when rising oil prices caused Americans to reconsider their 25-year love affair with gas-guzzling SUVs and light trucks, Canadians bought more of them than ever and drove them farther. The C.D. Howe Institute, a business-friendly think-tank, recently bemoaned the spread of outdoor patio heaters, driveway heaters, roof de-icers and desktop refrigerators, all bought without much thought to the energy they consume. Such attitudes will be hard to change.

The political task is almost as daunting. Several provinces have plans to reduce emissions, but all have different priorities.

Alberta, the prime minister's adopted home province, is a big emitter because of its coal-fired power stations and energy-guzzling production of oil from tar sands. In contrast, Quebec relies on hydro power and encourages public transport. Mr Harper needs to do well there if he is to turn his government's current minority status into a majority at the next election.



As for business, the degree of resistance to emissions curbs varies. Abitibi-Consolidated, a big paper producer, has already cut emissions from its Canadian mills to 42% below 1990 levels. But energy efficiency in the oil and gas industry has plummeted because companies in Alberta's oil sands use large amounts of natural gas to extract oil.

There is no shortage of suggestions for a new set of policies. Most borrow from international experience of pricing air pollution. The C.D. Howe Institute favours a carbon tax, compensated by cuts in other taxes. Another possibility is to use provincial schemes as building blocks for a national effort. Alberta and Quebec have already set up company registries for emissions, says Daniel Schwanen, an environmental analyst. It would cost Ottawa little to make them compatible.

Mr Harper could also look to the government's own advisory body, the National Round Table on the Environment and the Economy, which reported last month that emissions could be reduced by 60% by 2050. Technology is not the problem, said the report. What is needed is a clear signal from the government that it is serious about climate change. But so far Mr Harper has been uncharacteristically muddled. Perhaps a summer vacation—the ultimate Canadian antidote to long winters—will bring clarity.

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Trinidad and Tobago

Justice and the judge

Jul 20th 2006 | PORT OF SPAIN
From The Economist print edition

A conflict of race and power

IT IS not every day that the chief justice finds himself the target of an arrest warrant. That is the fate of Satnarine Sharma, Trinidad and Tobago's top judge. He is charged with attempting to pervert the course of justice in a case that has split legal and political opinion in the gas-rich Caribbean country.

Mr Sharma is accused of trying to help Basdeo Panday, a former prime minister who was sentenced in April to two years in prison for corruption. He is also alleged to have tried to squash a prosecution in 2004 of one of his doctors, who had been accused of committing a murder. Mr Sharma denies the charges—vigorously.

On July 14th, a high-court judge convened a special night-time hearing at which she stayed the arrest order against Mr Sharma. Under the constitution, the chief justice can also be investigated by a special tribunal of judges from the (British) Commonwealth. Patrick Manning, the prime minister and Mr Panday's chief political foe, has twice tried to set up such a tribunal, and twice been thwarted by court rulings.

This impasse may last for a while. Trinidad's courts move at a leisurely pace. Nobody expects a final decision on the chief justice before he retires in 2008. By then, the opposition hopes to have used the case to force an election. As so often in Trinidad, opinion splits mainly on racial lines. Most Indo-Trinidadians, who make up around 40% of the population of 1.3m, support the opposition. It sees Mr Sharma as a martyr to the machinations of Mr Manning and his mainly Afro-Trinidadian People's National Movement.

It will require patience and tolerance on all sides if the battle over Mr Sharma's future is not to become a full-blown conflict of powers between the government and the judiciary.

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Ecuador

The Colombians are coming

Jul 20th 2006 | QUITO
From The Economist print edition

Strains from an influx of refugees

Get article background

BEFORE declaring its independence in 1830, Ecuador was briefly united with Colombia. The two countries have retained close ties. Their border has long been porous, penetrated by both people and goods. But in recent years some Ecuadoreans have started to worry that it has become too porous.

Their concern is mainly prompted by the spillover from Colombia's battle against the drug trade and the leftist guerrillas of the FARC. Earlier this year, Ecuador complained that Colombian warplanes crossed the border when pursuing a FARC unit. It has also objected to Colombia's policy of spraying coca fields from the air with weedkiller; this has now been suspended close to the border. Meanwhile, the FARC uses the province of Sucumbíos, in northern Ecuador, for rest.

Around 7,000 Colombians each year formally apply for refugee status in Ecuador after fleeing violence. But in all, refugees may total as many as 250,000, according to the United Nations. Add in economic migrants, and the number is bigger still. Many have made their homes in Santo Domingo de los Colorados (now dubbed “de los Colombianos”), which has quickly turned from a small market town into Ecuador's third-largest city. Colombians are respected for their entrepreneurial and sales skills. Their bakeries display garishly coloured cakes in their windows, in contrast to dowdy locally-owned rivals.

Ecuador has been a “model country” towards refugees, but its tolerance could wear thin, worries Judy Cheng-Hopkins, a UN Assistant High Commissioner for Refugees. In 2004, the government began requiring Colombians to prove they lacked a criminal record before being allowed in. “These refugees are poor people who came over to a poor country to compete for resources with other poor people,” says Fredy Rivera of the Latin American Faculty of Social Science in Quito. But he adds that resentment has sometimes been fanned by local politicians and the media.

The Colombian invasion has brought much benefit to Ecuador's legal economy. But it may also have boosted the country's role in the drug trade. Ecuador has never been the site of significant coca production. But this month the army said it had found and destroyed four hectares (ten acres) of coca near the border. Days earlier, six tonnes of cocaine were found on a fishing boat 480km (300 miles) off the Galapagos Islands. It is becoming harder for Ecuador's politicians to claim that drugs are a purely Colombian problem.

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India's nuclear ambitions

The sound of one hand clapping

Jul 20th 2006 | DELHI
From The Economist print edition

There are many Indian critics, not just foreign ones, of the government's nuclear deal with America

EVEN in their moment of triumph in Delhi in March, the smirks of India's diplomats were tinged with doubt: had they overplayed their hand? George Bush and Manmohan Singh, India's prime minister, had just concluded a deal that promised India American co-operation in civil nuclear energy, despite its testing of nuclear weapons in 1998. This, its supporters gloated, would end India's nuclear isolation and usher in a new era of Indo-American partnership. But the deal required Congress to change American law. India's negotiators worried that the administration could not persuade it to do so.

In fact, it seems that it will be able to. But now attention has turned to the political fall-out in India. The agreement does not need the approval of India's parliament, and has strong supporters. But it has met with hostility from many quarters: the government's allies as well as its opponents; influential scientists and mandarins within India's nuclear establishment; and some respected commentators.

In the next few days, or soon after returning from recess in September, America's Congress is likely to approve legislation giving Mr Bush authority to waive, for India, some provisions of the Atomic Energy Act. This would allow nuclear co-operation, even though India has never signed the Non-Proliferation Treaty (NPT), and has no intention of doing so now.

Proliferation experts campaigned against the agreement in Washington, DC, outraged at its content and timing, just as the world is trying to curb the nuclear ambitions of Iran and North Korea. But the bill is now likely to sail through Congress, after being endorsed late last month by the foreign-relations committees of both houses.

Each house, however, tinkered with the bill, producing different versions that will have to be harmonised. In St Petersburg this week, Mr Singh told Mr Bush that India was concerned about the changes, which seem to impose more onerous conditions than were promised in March and when the plan was first announced last July. He reminded Mr Bush that his government, too, is accountable to the legislature. Mr Bush reassured him that there would be “no shifting of the goalposts”.

For many Indian observers, however, the goalposts were already in the wrong ballpark. The main opposition, the Bharatiya Janata Party (BJP), has accused the government of selling India short. This smacks of opportunism. The BJP would have jumped at such a deal had it been on offer when it was in government.

The Indian left is also hostile, and has suggested tabling a constitutional amendment to make such international agreements subject to parliamentary approval. The Communist parties, on which Mr Singh's coalition relies for a parliamentary majority, have taken especial exception to the bill's implications for India's ties with an old friend, Iran. One version of the bill now enjoins India to take a “full and active” part in restraining Iran's nuclear programme. India's Shia Muslims, deemed sympathetic to Iran, are strong in Uttar Pradesh, India's most populous state, where elections are due next year.

Non-proliferation “hawks” (in Indian terminology) worry that the agreement will give India the capacity massively to expand its nuclear arsenal, and so spark a regional arms race. Conversely, some Indian scientists, proud of what they achieved alone, argue that it will act to cap India's bombmaking, undermining its ability to build a “credible minimum deterrent”. Homi Sethna, a former chairman of the Atomic Energy Commission, has said that India would be better off signing the NPT. An Indian nuclear scientist could scarcely say anything more damning.

The Indian government has argued that the deal is purely about India's energy needs. But critics say that, even on the most optimistic assumptions, nuclear power will contribute only about 4% of India's power-generation by 2020. They suspect an American ploy to win huge contracts for its nuclear-power industry, or, in the words of Brahma Chellaney, a leading strategic thinker, of using “an energy bait to gain a handle on India's main strategic asset, its nuclear-weapons programme”.

Yet, in the same breath, the government also advertises this agreement as marking a “permanent reconciliation” with America. That, of course, is precisely why leftist critics do not like it, fearing the loss of India's non-alignment. Opinion polls, however, suggest that India is one of the few countries where America remains highly popular. This will encourage the government to ignore the howls of protest and press ahead with the deal's next stages: negotiating a detailed agreement with America, seeking approval from the 44-member Nuclear Suppliers Group of countries, agreeing on international safeguards, and returning to Congress with the completed package. The sequence of all this also raises Indian hackles. The government had said that the safeguards negotiations would follow a change in American law.

The congressional amendments have given the deal's Indian opponents an opening, and the debate in India is likely to heat up. An accord Mr Singh and his allies portrayed as an historic breakthrough, symbolising the end of decades of mutual Indo-American mistrust, has revealed just how deep that mistrust runs.

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Japanese diplomacy

Assertiveness training

Jul 20th 2006 | TOKYO AND BEIJING
From The Economist print edition

Hardball, for a change

AFP

Japan takes it to the council

SINCE North Korea's outburst on July 5th, when the regime of Kim Jong Il fired off seven missiles, including a long-range ballistic Taepodong-2, into neighbouring seas, Japan has displayed a sense of purpose that has surprised even its own diplomats, usually more inclined to follow than to lead. After the firings, Japan immediately called an emergency meeting of the UN Security Council. It drafted a resolution condemning North Korea's actions and calling for sanctions backed by force. This was the first time in living memory that Japan had seized the diplomatic initiative—and about time too, say the many policymakers who want their country to play a more assertive role in the world. “Japan”, boasts one, “has lost her virginity.”

But what a horrible experience it might nearly have been. For though Japan's toughness drew praise from America, Britain and France, among others, an element of hyperbole in its reaction unsettled even some supporters. After all, North Korea already has dozens of medium-range missiles able to reach Japan, so a Taepodong-2 (which blew up) hardly adds to the tally. American policymakers still judge North Korea's presumed manufacture of nuclear bombs to be the chief concern. What is more, Japan's noise and fury seemed to be orchestrated by Abe Shinzo, the chief cabinet secretary, for a domestic audience. He is seeking to replace Junichiro Koizumi, the prime minister, in party elections in September. His popularity at home rests in part on taking a hard line against North Korea, hitherto over the regime's refusal fully to account for Japanese kidnapped in the 1970s and 1980s. After the firings, Mr Abe even mused publicly about pacifist Japan making pre-emptive strikes on North Korean missile facilities (though Japan lacks the means at present). That enraged Japan's neighbours, South Korea and China, as much as North Korea.

But Japan's assertiveness very nearly came to grief by appearing not to want to give diplomacy a chance to bring the isolated regime back to the six-party talks involving America, China, South Korea, Japan and Russia. Everyone outside Pyongyang agrees these are the best forum in which to solve North Korean issues. While Japan was merely sounding shrill, China encouragingly said it was sending a high-ranking delegation to Pyongyang to talk reason. Under pressure from America, its ally and mentor, Japan agreed to withdraw its Security Council resolution for a few days.

Had China succeeded in bringing North Korea back to the talks, Japan's diplomacy would have looked badly miscalibrated. As it was, the North Koreans snubbed their only ally, to evident Japanese relief. The action returned to the Security Council. China said it would veto a resolution that threatened force. But with its president, Hu Jintao, under pressure to look statesmanlike as a guest of the G8 in St Petersburg, it agreed on July 15th to a compromise, brokered by Britain, that still strongly condemned the missile tests and banned the transfer of missile-related technology to North Korea. At last China had shown a degree of annoyance with its North Korean neighbour, a striking development after years of avoiding even the mildest criticism—indicating, perhaps, that China has run out of other ideas for bringing North Korea to heel.

Some seasoned observers have doubts about Japan's new assertiveness. The problem with being pushy, they say, is that this approach goes down much better at home than it does with those you are pushing about abroad. But now that Japan seems at last to have lost its diplomatic virginity, there can be no

going back.

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China and North Korea

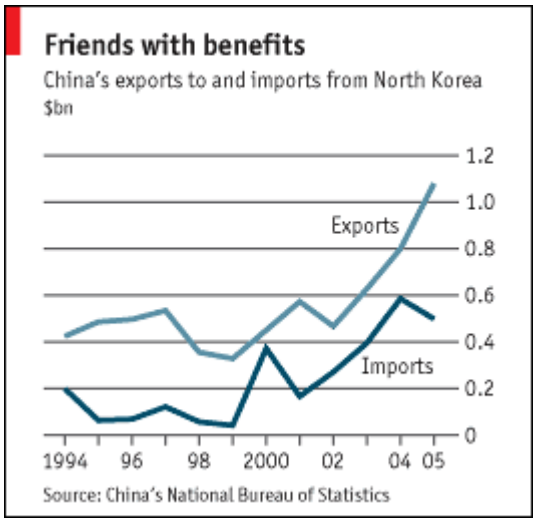
Friendship and trade

Jul 20th 2006 | DANDONG
From The Economist print edition

Slowly, trade is picking up

CHINA'S main lifeline to North Korea, a narrow road-and-rail bridge across the Yalu river, does not suggest there is much business to do on the other side. A trickle of trucks flows along its single-lane carriageway, which stretches for less than 1km (barely half a mile). Hours go by without a train. The North Koreans hoped a few years ago to create a busy investment zone on their side, but all they have is a shabby town of mostly idle factories. At night it is an expanse of darkness with only a few pinpricks of light.

Yet trade is picking up. Chinese trucks crossing the Friendship bridge—built by the Japanese in 1943 and bombed by the Americans during the Korean war—are filled with more than just the bare necessities of life. China still props up North Korea with supplies of grain and oil. But in the past few years the trucks have begun transporting more machinery for factories and electronic products such as television sets for a small but affluent elite. And North Korean businessmen have become a familiar sight in Dandong, at the Chinese end of the bridge, staying at the best hotels in what to them must seem a fantasy land of bourgeois luxury.



China exported $1.08 billion-worth of goods to North Korea last year, 35% more than in 2004 and 122% more than in 1995, according to Chinese statistics (see chart). More than half of all trade in 2005 was handled by Dandong. Less promisingly for North Korea, exports to China fell by 14.8% to $499m. North Korea makes little of interest to the Chinese, as the paltry array of North Korean trinkets on sale in Dandong suggests. But there is demand for North Korea's raw materials. Dandong's tour boats take visitors close to the North Korean bank where they can see timber piled up ready for shipment across the river—close to a hotel that rarely has guests and a fairground Ferris wheel that never moves.

Some Chinese even show interest in investing in North Korea. Sinuiju, the town on the North Korean side of the bridge, has attracted little attention since North Korea declared it to be an investment zone in 2002. The Chinese-born Dutch businessman named by North Korea to run the zone was jailed for fraud by China soon afterwards. North Korea has since devoted more attention to developing Kaesong near its border with South Korea.

But a dozen or so Dandong firms have recently set up businesses, ranging from restaurants to a factory making cigarette lighters. In Dandong's main bookshop, the only book on North Korea is a guide for investors. It advises Chinese businesses not to rush in blindly, not to expect quick returns and not to comment on North Korean politics.

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Indonesia

Jul 20th 2006
From The Economist print edition

AFP

Another tsunami struck Indonesia on July 17th. This one, caused by an earthquake off the south coast of Java, killed more than 500 people. An early-warning system proposed after the catastrophic tsunami of December 2004 is not yet operational, but might not have saved many lives. The wave hit the coast 40 minutes after the quake was detected.

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Thailand

Who needs politicians?

Jul 20th 2006 | BANKOK
From The Economist print edition

Without a parliament, the country is ticking along nicely—for now

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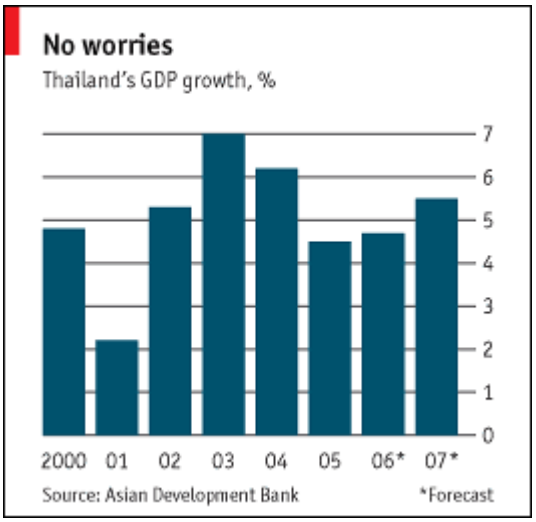

THAILAND has had but a caretaker government, and no parliament, for five months now. The country's two main political parties face possible dissolution for "unconstitutional" behaviour. The election commissioners are on trial in the criminal courts. No one is sure if fresh elections called for mid-October will take place. Thaksin Shinawatra seems determined to stay on as prime minister, while anti-Thaksin protest leaders remain convinced that one last shove will force him out.

Yet so far there are few signs that the country's political meltdown is having much effect on the economy or on the lives of ordinary Thais. Economists' predictions are less rosy than at the start of the year, but only slightly. New forecasts this week from the Asian Development Bank (ADB) suggest the Thai economy will accelerate, from 4.5% growth last year to 4.7% this year and 5.5% in 2007. Strong growth worldwide, especially in East Asia, is providing a following wind to help Thailand sail on through its choppy political waters.

Surveys do suggest that consumers' confidence has been hurt by all the political uncertainty. Yet aggressive marketing of credit by the banks is encouraging them to continue spending, as illustrated by the ever more extravagant shopping malls going up in Bangkok.

The lack of a parliament means that no budget has been passed for the new fiscal year, starting in October. At best, several months' delay seems likely. But, as in the Philippines, whose lawmakers have failed to pass a budget, the government can continue paying civil servants' salaries and running basic services. The damage will be felt only in the longer term, since the main effect may be to delay the start of big infrastructure projects, from roads to irrigation schemes.

The Thai government's finances are pretty stable. The ADB predicts they will be in surplus this year to the tune of 0.5% of GDP. It notes that the country's burgeoning reserves now almost equal its entire foreign debt. All this calms investors' nerves. Most assume, in any case, that the political crisis is less serious than it looks and that a stable government and parliament will be restored fairly soon.

This week, though, it emerged that Seagate, an American technology firm, had chosen Malaysia over Thailand for a new plant. The government admitted that political uncertainty was also worrying Japanese investors. Still, Nissan said this week it would build a big distribution hub near Bangkok to export locally-made car parts.

Among the few moderately urgent measures endangered by the lack of a parliament and a credible government are the free-trade deals that Thailand is seeking with America and Japan. The Bush administration is rushing to sign deals before its "fast-track" negotiating authority from Congress runs out next July. Thailand could get sidelined if America's negotiators find they are making more headway with other countries, such as Malaysia.

The political crisis, meanwhile, is not over. Rallies against Mr Thaksin were suspended for the celebrations last month of King Bhumibol's diamond jubilee, and then further postponed out of respect

for the 78-year-old monarch, who is unwell after suffering a fall. But as long Mr Thaksin remains in power, his opponents will struggle to maintain their self-control.

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Afghanistan and Pakistan

Still crazy after all these years

Jul 20th 2006 | KABUL
From The Economist print edition

The Durand line, drawn in 1893, still causes trouble

AT THE entrance to the Khyber Pass, the Torkham border crossing is undergoing a facelift. From Pakistani territory, old British-built forts still command the dusty Afghan approaches to this, one of two main crossing points on the so-called Durand line. But on the Afghan side, a series of smart offices have just been completed. Paid for by the EU, they house a computerised import-duty system.

Ideally, this would help to boost the Afghan government's income from the pitiful $330m it raised domestically last year. The problems, though, are evident an hour's off-road drive to the south, where thousands of new car tyres are stacked waiting for the lines of donkeys that plod the myriad smuggling routes. Car parts, electrical goods and opium, amongst other contraband, go one way over the mountains; cigarettes, guns and, periodically, Taliban insurgents go the other. The Durand line leaks like a sieve in both directions.

The 2,500km (1,600 mile) border, which still carries the name of Sir Mortimer Durand, the British diplomat who drew it, runs from China, via the Wakhan Corridor and the mountainous tribal belt of Pakistan's North-West Frontier Province down into the shimmering heat of the Baluch deserts and Iran. The imagery is romantic, but the practicalities of the 1893 border have been a perpetual headache for both Afghanistan and what is now Pakistan—and since the toppling of the Taliban in 2001 for the outside world as well. The fiercely independent Pushtun tribes that spill across both sides of the line have never paid it much attention, crossing without documentation today in the same way that they always have.

In March, Afghanistan's parliament contemptuously rejected an offer by Pakistan to fence the Durand line or even lay mines along its length. This followed months of acrimonious exchange over the infiltration of Taliban from Pakistan's lawless tribal areas, where Osama bin Laden and his deputy, Ayman al-Zawahiri, are both believed to have taken refuge.

Many Afghan parliamentarians dismissed the fence offer as a ruse by the Pakistani government to force acceptance of a border which successive Afghan governments, and the overwhelming majority of

ordinary Afghans, regard as illegal. The commander of the border police at Torkham says Attock on the Indus river is the true border. An almost universal belief persists in Afghanistan that the original Durand agreement was valid only for 100 years. But there is no such wording in the document and Afghan officials admit privately that any appeal to international law on the issue would fail.

Were it to be realised by other means “Greater Pushtunistan”, in its most extravagant form, envisions a state that would take in southern Afghanistan and much of western Pakistan: a terrible vision for the government in Islamabad. It is this fear, as much as any desire for a weak client state at its back, which the Afghan government blames for Pakistan's continuous promotion of various Pushtun Islamist protégés over the past 30 years.

The most recent, the Afghan Taliban and their spiritual brethren in Pakistan, have helped dampen separatist sentiment on the Pakistan side of the border. But the Taliban have also created terrorist mayhem in southern Afghanistan and increasingly in Pakistan's own tribal areas of North and South Waziristan.

In Islamabad and Kabul there are thoughts of a gradual economic integration of the border region as a way of diffusing the issue. An American-backed plan on the table since March suggests what are being called “Reconstruction Opportunity Zones”. These would allow goods manufactured in the border areas with input from communities on both sides to be exempt from American import tariffs.

It is a nice idea, though of doubtful practicality right now. Cross-border *froideur* and the security situation are hardly conducive. Still, as one Afghan government official puts it, more in hope than expectation: “It is better to build bridges than walls between brothers.”

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China

The play's the thing

Jul 20th 2006 | BEIJING
From The Economist print edition

How will the party react?

THEATRES and politics can be a potent combination in China. Mao Zedong's objections to a play that appeared to be a veiled attack on him marked the first stirrings of the Cultural Revolution. Playwrights have learned to be careful since then. But a new play now being performed in Beijing is testing the bounds of official tolerance.

The playwright, Zhang Guangtian, has tried his luck before. In 2001 he directed “Che Guevara”, a play by one of China's “neo-leftist” intellectuals who fear the country has strayed too far from the principles of communism. Through the life of the revolutionary, it attacked a lack of social justice in China. Others have pushed the bounds too. In 2002, a version of Orwell's “Animal Farm” made it past the censors.

But in “Yuanmingyuan”, Mr Zhang takes China on more directly. It attacks a basic tenet of Chinese nationalism, that foreign troops destroyed Yuanmingyuan, an imperial palace north of Beijing that was indeed laid waste by British, French and other invaders in 1860 and again in 1900. Mr Zhang says foreigners burned it, but his play attacks the Chinese who helped them and who continued to destroy what remained in the decades that followed.

The near obliteration of Yuanmingyuan by the greedy, corrupt and misguided—the Red Guards are fingered, as well as officials who began last year to revive it as an amusement park, involving much use of plastic sheeting—becomes an allegory for the ravaging of China generally in the course of its breakneck development. “First it's class struggle as the central task, then boosting GDP. When will the people be the central issue?” laments one character.

At one point the audience is showered with leaflets, including one with a headline saying, “The Crisis is Upon You”, and citing statistics such as that 400m Chinese breathe heavily polluted air and 300m peasants have no clean water supply. Official corruption, the growing gap between rich and poor, appalling safety conditions in China's mines are among the problems raised.

Officials in the state environmental-protection agency have supported Mr Zhang's production. Whether that will keep it going until its last scheduled performance, on August 5th, will be a revealing test of the party's tolerance.

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Uganda and Sudan

A rumble in the jungle

Jul 20th 2006 | JUBA
From The Economist print edition

The Lord's Resistance Army tries to explain itself

Getty Images

MORE renowned for kidnapping children, massacring peasants and chopping off lips than anything else, the Lord's Resistance Army (LRA) has rarely bothered to articulate its grievances. But now that the secretive Ugandan rebel group has finally come out of the bush to attend peace talks with the Ugandan government, hosted by neighbouring southern Sudan, it is seizing every opportunity to paint itself as a group of valiant freedom fighters, battling the oppression of the Ugandan president, Yoweri Museveni, and his power-hungry ethnic elite.

Few in Uganda will believe much of this. But since the talks started last weekend, the rebels realise that they have to give some sort of justification for the mayhem they have caused, not least among their own Acholi people. Up to now, what most people have learnt about the LRA is that it wants to rule Uganda according to the Ten Commandments.

Long regarded as nothing more than a small bunch of madmen roaming the wilds of northern Uganda, the LRA has come under increased international scrutiny in recent years. The dreadful consequences of its guerrilla war are partly what has forced it to the negotiating table. Almost 2m northern Ugandans have been forced to live in squalid camps as part of the government's counter-insurgency strategy, while the rebels' move last year to Garamba, in Congo, broadened the conflict. The first-ever indictments for war crimes by the International Criminal Court in The Hague were issued last year against the LRA's leader, Joseph Kony, and his four top commanders.

Mr Kony faces 33 charges, including murder and sexual enslavement. Now eager to cast himself as the defender of a legitimate cause, he has given his first television interview, denying the charges and saying he wants peace.

The rebel delegates at the talks in Juba, southern Sudan's capital, started outlining their demands for a political solution to a rebellion that started 19 years ago. They want a greater share of power and wealth for their native north, though they have yet to spell out specific proposals, beyond calls for compensation for cattle looted by Mr Museveni's forces and a quota system to give northerners more access to state jobs and education. They also want the Ugandan government to close its camps in the north and to

disband the national army, before reconstituting it under international supervision to redress what they say is discrimination against northerners.

The big man hasn't yet turned up

Also on the agenda this week was a ceasefire. The rebels want one immediately, but Uganda says that the LRA has used such agreements in the past to rearm, so it will not accept a truce until a final, comprehensive agreement is signed. Whether the two sides can broker such a deal will depend a lot on whether Mr Kony and his fellow indictees feel confident enough to take part in the negotiations.

Mr Kony sent others to this first round in his stead. Mr Museveni has offered to protect Mr Kony and the four wanted commanders from prosecutors in The Hague for the duration of the talks, though he has no legal authority to do this. The rebels are mindful of the fate of Liberia's former president, Charles Taylor, who was flown off to The Hague last month to face war-crimes charges, three years after he had agreed to a peace deal.

The absence of the LRA leaders will complicate and slow the talks. The rebel delegates in Juba are mostly members of northern Uganda's Acholi tribe who live in London and Nairobi, many of whom have not been home for years; they include a teacher, a lawyer and a businessman. Some see them as little better than opportunists who are after personal gain and have little idea of the revulsion the rebels have generated among their own people in the north.

The irony is that their complaints about graft and nepotism would resonate with many Ugandans, were it not for the rebels' brutality. Mr Museveni changed the constitution last year, allowing him to win a third term in February's elections and raising fears that he intends to hang on for life. Meanwhile, Ugandan officials regard the LRA as a vanquished force; proposals to reconstitute the army under foreign control are, they say, unthinkable. The only thing the government still wants to discuss is the terms of the LRA's surrender.

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Kenya

Hallelujah!

Jul 20th 2006 | NAIROBI
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The rise of Pentecostalism could change the face of Kenya

IT IS not a country known for its enterprise, except when it comes to the business of selling God. Countless churches line Kenya's narrow pot-holed roads, and particularly so in the damp highlands and the lush lowlands encircling Lake Victoria. Sundays are busy: even the most meagre Nairobi slum pours out church elders in jacket and tie and little girls prim in white dresses and coloured bows.

Most of the churches they attend were instituted by 19th-century missionaries: Anglicans, Presbyterians, Methodists, a few Quakers, and a large number of Roman Catholics. But there is plenty of competition for souls; and as in America and other parts of Africa, notably Nigeria, it is the Pentecostalists who are putting the squeeze on the established churches.

AP

Have you been saved?

Around 15% of Kenyans now attend Pentecostalist churches. That number is expected to rise as Kenyans continue to flock to the towns. Country Pentecostalists tend to be poor, gathering in shacks with fanciful names (“Arsenal Revives, Christ Redeems”, for instance). But these are usually one-off congregations, commanded by a preacher of sometimes dubious provenance, with a writhing in the shadows that comes with speaking in tongues.

Urban Pentecostalists are more upwardly mobile. Whereas their country cousins want a dollop of hope, they are more interested in entertainment. With little money for outings, they gravitate towards the showmanship of Pentecostalism, whose larger churches combine unequivocal sermons with thumping music. Even the more successful churches are kept on their toes by the market approach of Pentecostalism, in which each congregation is encouraged to be more or less responsible for its own development.

The denomination's success is also partly due to its conservatism, which goes down well in a country raised on the literalism of missionaries. Homosexuality is an “abomination”. Creationism is deemed a fact—so much so that the National Museum of Kenya has had to hide away its precious trove of ancient human remains to protect them from Christians who want them destroyed.

This kind of talk poses a problem to the established churches. Their attitudes to the use of condoms aside, the Roman Catholics have remained fairly buoyant, speaking up for the poor and taking their cue from Rome. But the Anglicans and other old Protestant churches are losing ground to the Pentecostalists. To compete, they are shoring up their faithful with a similarly conservative message.

The Anglican Church will not die out: it is still the church of choice for Kenya's influential country-club set. But in a country where homosexuals can be beaten to death with impunity, the idea of a gay clergyman (let alone a bishop) is anathema. A traumatic split with the mother church in Canterbury looks inevitable.

The Pentecostalists have no such worries. Indeed, their loose structure makes them ripe for a profitable consolidation. One man to do it is T.D. Jakes, an American Pentecostalist (pictured above). He has taken Kenya under his wing. Kenyans, in turn, have styled him “our Joseph”. He drew nearly 1m people to Uhuru Park in central Nairobi on a recent visit, far more than would attend a political rally.

Mr Jakes did not hold back. He told the Kenyans that Africa had “small” leaders because the people have a “slave mentality”. Kenyans had a duty to invest in themselves and in the market—and America had to help them do it. Mr Jakes's message of self-empowerment, cribbed now by most aspiring Kenyan evangelists, may even make a political impact.

Another impact of Christian evangelism, in the longer run, may be a worsening of relations with Muslims, who make up about 8% of Kenya's population. Some mullahs have been copying the sales pitch of the Pentecostalists, but with an emphasis on Muslim ascendancy rather than self-empowerment. There are signs of tension. A Pentecostalist radio station was torched in May and several people shot after a broadcaster compared passages of the Bible and the Koran on air.

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South Africa

On a sticky wicket

Jul 20th 2006 | JOHANNESBURG
From The Economist print edition

Sport remains a template for racial desegregation

AFP

The field of dreams

Get article background

NEXT week should see a historic moment in the history of South African cricket. For the first time, the national team will be captained by a non-white player, Ashwell Prince, during its tour of Sri Lanka. It may only be a temporary appointment, while the usual (white) captain recovers from injury. But in a country obsessed equally by sport and race, it has caused a stir. For some, it is a shining example of the real progress that South Africa has made towards racial integration since the end of apartheid in 1994. For others, though, the entire furore merely shows that the “rainbow nation” still cannot get beyond the question of race.

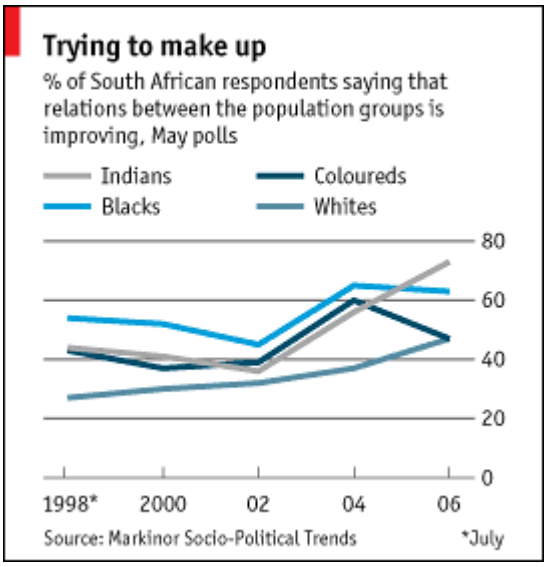
In a country where sport is virtually a religion, the racial politics of the traditionally white sports of cricket and rugby matter enormously. After all, the sports boycott of South Africa helped bring down apartheid in the first place. Added to that, South Africa now has the pressure of hosting football's World Cup in 2010, which will subject all its sports to yet more scrutiny. The government also knows that the big tournaments can be exploited to forge a new spirit of unity, as Nelson Mandela did so expertly when South Africa won rugby's World Cup in 1995.

There have undoubtedly been signs of change in cricket and rugby. Where national teams used to be all white, five players of the 13-strong squad going to Sri Lanka are coloured (ie, mixed-race), black or Indian; South Africa's star bowler, Makhaya Ntini, is black. Last year the Springboks, the national rugby team, fielded six black or coloured players in its starting 15, the highest proportion ever, in a match against Australia. By contrast, when the Springboks won the World Cup in 1995, all the players but one were white. Jake White, the coach since 2004, has selected more black players than any of his predecessors and won two-thirds of his matches in the process—though last week's record defeat against Australia left many fans in a state of dazed depression.

There are no formal racial quotas in the national teams, but there is a lot of pressure on coaches and selectors to increase black and coloured representation; rugby and cricket are both governed by so-called “transformation” charters. Nonetheless, this is still not enough for many in the ruling African National Congress, who want to see the teams reflect the racial makeup of the country more exactly; whites make up only 9% of the population. In May, Parliament's sports committee lashed out at the rugby authorities

for keeping the sport too white and criticised Mr White for not selecting enough black players. The minister of sports, Makhenkesi Stofile, has also complained that sports, and rugby in particular, were not changing fast enough.

But some South African sportsmen think that the people who run sport have now become oversensitive on this score. The likes of Kevin Pietersen, now a star cricketer for England, and Clyde Rathbone, who plays for Australia's rugby team, complained that formal quotas, imposed at some levels of rugby and cricket until a few years ago, hindered their development. So they took their careers abroad. Some white players fear that selection is increasingly based on skin colour rather than merit, to the long-term detriment of South African sport. Last week, when introducing the transformation charter, Willie Basson, of the South African rugby union, said that there had been too much emphasis on the number of black players in the national team and not enough on enlarging the pool of black talent.



Better training, fewer quotas

These complaints are echoed by the opposition. According to the Democratic Alliance (DA), the government's role should be to develop and train youngsters, by building more sports fields in townships and rural areas, rather than meddling in player selection. “It is a bottom-up approach that will achieve the diversity we would all like to see in our top teams,” says Donald Lee, a DA MP.

This argument is hardly confined to sports. The government's efforts to carve out more space for non-whites in business and finance, known as black economic empowerment (BEE), have raised similar concerns. Virtually all South Africans, of whatever colour, agree that the crippling inequalities inherited from apartheid need to be corrected. But the controversy grows as to whether BEE, which requires racial auditing of companies, or the artificial pressures on cricket and rugby, are the best way to go about it.

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Rwanda

Ethical tourism

Jul 20th 2006 | KIGALI
From The Economist print edition

In a country notorious for its genocide, tourism may heal wounds

SERENITY is not a word that springs to mind when mention is made of Rwanda, where nearly 1m people were slaughtered in 1994, mostly Tutsis killed by their Hutu compatriots. Yet the serenity—of its countryside and people—is what the Rwandan government is marketing in an effort to woo tourists. It also hopes that tourism can help heal the wounds inflicted by the genocide.

Rwanda has come a long way since 1994. Under President Paul Kagame, ethnic divisions are less harsh, crime rates have fallen, the economy is growing at 4% a year and the country's politics seem stable. As for tourism, Rwanda boasts a diverse landscape of volcanic mountains, verdant hills, shimmering lakes and rolling savannah. The country's mountain gorillas are the world's most accessible.

But Rwanda's gruesome recent history is not hidden. Tourist itineraries include harrowing but educational “genocide sites”. In a former school in the town of Murambi, 64 classrooms contain the bodies of people who died there, lying in the twisted repose of death, covered with lime. In Kigali, the capital, a museum serves as a more traditional memorial to the genocide, a flower garden covering the mass graves of nameless victims.

Before the genocide, tourism was Rwanda's third biggest foreign-exchange earner. After a dip, it is now is projected to bring in $42m next year. The government wants that figure to rise to $100m by 2010. Its Office of Tourism and National Parks reckons that “high-end ethical tourism” is the way to go, with profits equitably distributed across the country: every year, 5% of the income generated from state-owned national parks is handed to local communities for spending on projects of their own choice.

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Central Europe

The shoelace handicap

Jul 20th 2006 | WARSAW
From The Economist print edition

Central Europe risks becoming a bad advertisement for the further expansion of the European Union

TIME was when “new Europe” felt superior to “old Europe”. Before joining the European Union in May 2004, the eight ex-communist candidates transformed their economies and political systems, changing everything from competition policy to food-hygiene rules. They dumped bad communist habits and odd post-communist ones alike. Governments of left and right showed impressive determination to qualify for the club. Those that the European Commission found lagging, such as Lithuania and Slovakia, made strenuous efforts to catch up. Abroad, new Europe proved an eager ally, deploying armed forces for peacekeeping in the Balkans and for American-led interventions in Afghanistan in 2001 and Iraq in 2003.

Some of the headiness of that era still lingers. The newcomers' economies continue to grow strongly (see chart). At this rate, living standards will catch up with the European average within a generation. But in many other respects, the region is stagnant or going backwards. The reform momentum has petered out. These days the only ex-communist country with a strong reformist government is Romania. It, along with somewhat less reformist Bulgaria, is outside the EU. Both expect to join in 2007.

For their counterparts inside the EU, political weakness seems now to be the rule. The Czech Republic, after a tie in last month's election, has no government at all. Estonia, Latvia and Slovenia all have cautious coalitions, preoccupied with sharing the fruits of power rather than pursuing further reform. In Slovakia and Poland the coalitions have an added ingredient: extremist populist parties of left and right. Lithuania has a weak minority government. Only Hungary has a solid government made up of mainstream parties—and it is probably in the most alarming economic situation. Public debt is ballooning, and both the currency and bond markets look wobbly.

The effect is like that of a bunch of runners going briskly but with their shoelaces undone. Accidents are waiting to happen across the region. In Estonia and Latvia, the fear is of runaway growth—a nice problem, perhaps, but one that risks a crash. One possible cooling mechanism would be for the two to open their labour markets to migrants, but neither government has the vision or grit to push that through.

Lithuania and the Czech Republic suffer from fractured political systems unable to produce any plausible government. In contrast, Poland and Slovakia suffer from too much government, not too little. After nine months of bickering, Poland's new prime minister, Jaroslaw Kaczynski, won a vote of confidence this week. But his priorities are moral—eg, purging ex-communists—not economic. He has few convincing plans to trim the state and create the sort of modern economy that might tempt back the 1m-plus Poles working abroad.

Foreign policy is flagging too. Enthusiasm for American-led coalitions has cooled, but with no alternative in sight. There is no coherent strategy from the eight central European countries on such crucial issues as relations with Russia or energy security. Poland, for example, is trying to diversify its gas supplies, whereas Hungary is co-operating with Russian efforts to prevent this.

To be fair, cynicism and timidity over reform are not unique to the post-communist bit of Europe. Nor are extremist or populist parties. Italy's post-fascist party, Flemish nationalists, Jean-Marie Le Pen in France, and Austria's Jörg Haider have all pushed the boundaries of tolerance farther than their counterparts to the east.

Nor is it clear that the region is suffering now from bad (or no) governments. One common worry is that it may damage their chances of joining either the Schengen passport-free area, or the euro, or both. Yet, given today's fears in western Europe over legal and illegal migration, the expansion of Schengen is some way off. As for the euro, joining the single currency looks a risky step, particularly for the larger ex-communist countries—so a slippage in the timetable may be no bad thing.

The real dangers are different. One is that the central Europeans need deeper reforms if they are to stay ahead as their labour costs rise. Being cheap has served them well, but they now face competition from countries that are cheaper still: Romania and Bulgaria close to home, China and India farther afield. That puts the emphasis on quality, flexibility and innovation—none of which is a strong point. Universities are mediocre and overcrowded, even by the dire standards of continental Europe. Spending on research is feeble.

Worst of all, unstable and populist governments in the new democracies offer a poor advertisement for continued EU expansion. Arguably, the prospect of EU membership for the western Balkans is all that prevents a return to violence there. In the longer run, the lure of joining the EU is also the best way to keep Turkey, or ex-Soviet countries such as Ukraine and Georgia, on the right track.

But are politicians in western Europe ready to tell their voters that the EU needs more countries like those that joined in 2004? Support in old Europe for further expansion is sliding: in the 15 old members, only 41% are now in favour, compared with 47% in 2003 (and 66% in the new members). Nutty politicians in Poland and Slovakia, baffling stalemates in the Czech Republic and Lithuania and a belief that a chunk of the continent will stay backward may lead voters farther west to feel disappointed by past enlargements—and to be hostile to any future one.

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The G8 summit

Russia triumphant

Jul 20th 2006 | ST PETERSBURG
From The Economist print edition

A triumph for Russia's president; a waste of time for everyone else

THE tame bears were evicted from their haunt next to the Hermitage museum. Shops selling bootleg DVDs were mysteriously shut. St Petersburg had its best European face on, and its sinister under-belly well hidden, when leaders of the world's richest democracies came to town for their annual G8 pow-wow last weekend.

They mostly only pretended to agree, as a fence-sitting statement on the Middle East, thrashed out by Vladimir Putin and Britain's Tony Blair, showed. Mr Putin chose energy security as a summit theme, and on this, too, there was a bland statement. The Europeans hoped to get Russia to ratify the Energy Charter, a liberalising treaty, and to open its gas pipelines to companies other than Gazprom. They failed; Mr Putin seemed pleased.

EPA

Putin in excelsis

Indeed, Mr Putin, who grew up in St Petersburg, was the summit's only winner. There were disappointments. Despite the shop closures—perhaps meant to allay worries over intellectual piracy—Russia and America failed to strike a deal that would have let Russia join the World Trade Organisation. Kremlin henchmen from Moscow derided the efforts of the St Petersburg authorities to dispel the clouds by seeding them: Moscow's mayor is much better at it, they said, as the rain washed out an outdoor reception.

But the Russians made pre-summit weather of their own, in the form of an initial public offering for Rosneft, an oil giant (see article), and the death of Shamil Basayev, Russia's most-wanted terrorist. Mr Putin's guests obliged him by not saying anything too awkward about his domestic policies. In public, George Bush said only that Russia would find its own version of democracy—exactly the argument that the Kremlin uses to explain why its version does not resemble anyone else's.

Perhaps sensing weakness, it was Mr Putin who did the embarrassing. “We certainly wouldn't want to have the kind of democracy that exists in Iraq,” Mr Putin said. A rogue microphone later caught Mr Bush telling Mr Blair that “what they need to do is get Syria to get Hizbullah to stop doing this shit”: rumours swirled that Mr Putin had switched it on himself. He had a dig at Mr Blair too, alluding to a British scandal over the alleged sale of honours.

Nor was there much disruption of his imperial moment in the city. Only a few communists, anarchists and the odd democrat braved the riot police. Among the rag-tag bunch were Stalin admirers (“A Real Man”, said their banner), Brezhnev lookalikes, and Valentina, a street-cleaner wearing a portrait of Alyaksandr Lukashenka, president of Belarus, around her neck. “Putin is no one,” she said—but things would be even worse without him. A youthful communist took offence when questioned about her designer jeans.

Nearby, two young women advertised a special promotion at a local tanning studio. Were they concerned about freedom of speech? “This is freedom of speech,” said one, pointing to her friend, who, like her, was wearing a short skirt and a tinsel wig, and carrying a yellow balloon. Mr Putin would have been proud.

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Italy and the CIA

Account rendered

Jul 20th 2006 | ROME
From The Economist print edition

An increasingly embarrassing investigation of a CIA kidnapping in Milan

AS PROSECUTORS dig into the disappearance from Milan three years ago of an Islamist cleric suspected of being a terrorist, they are sending tremors through Italy's intelligence services and beyond. Their investigation of the seizure of Hassan Mustafa Osama Nasr, or Abu Omar, is the most detailed so far into an “extraordinary rendition” (ie, nabbing suspects and spiriting them to third countries where they may be tortured). Prosecutors have issued arrest warrants for 26 suspected CIA agents and even jailed (temporarily) the deputy chief of Italy's military intelligence service, SISMI.

Last weekend they interrogated the chief, General Nicolo Pollari—as a suspect accused of abetting a kidnapping. Leaks from the inquiry point to evidence in the prosecutors' hands that CIA agents did not just sneak into Italy and snatch Abu Omar, but also notified SISMI of their plans, and perhaps even got help from it. The general apparently suggested that authorisation for this came from above. Although he availed himself of his right to silence, his lawyers told prosecutors to find a letter that their client apparently wrote to the government of Silvio Berlusconi.

In the letter, the general supposedly informed his political masters of the CIA's operation—and said he would resign if they let it go ahead. If it emerges that he was overruled, that would embarrass Mr Berlusconi, who last week again denied advance knowledge of the kidnapping. But the general's defence invites questions. Why did he stay in his job and why did he testify to both the Italian and European Parliaments that he was ignorant of the CIA's plans?

Under Italian law, the prosecutors must pursue inquiries into evidence of what is unquestionably a serious crime. But, as a former Italian president, Francesco Cossiga, has said, they are also causing unquestionable discomfort to a service that has helped to shield Italy from attack by Islamist terrorists. Its friends in other intelligence services will be appalled to learn that police acting for the prosecutors have tapped calls to and from senior SISMI officials—and that the transcripts could become public documents if indictments are brought.

In all the furore, Abu Omar himself has been all but forgotten. His lawyer says that he is in Cairo's al-Tora prison, where he has been repeatedly tortured, and has three times attempted suicide.

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Serbia at bay

The nationalist backlash

Jul 20th 2006 | BELGRADE
From The Economist print edition

A nasty outbreak in the Balkans

Get article background

IT HAS long been said that there are two Serbias. One is conservative, nationalist and backward-looking; the other liberal, modern and progressive. In today's politics, the first is on the offensive and the second on the defensive. Serbia faces crucial choices—and it may decide not to resume its path towards European integration.

Two weeks ago, tens of thousands of young Serbs converged on the city of Novi Sad for the Exit music festival, where big-name bands from all of Europe play. Exit is fascinating because it provides a glimpse of the Serbia that could be. It is well organised, peaceful, fun—and it attracts thousands of visitors from across former Yugoslavia. But ask young Serbs what the future holds and gloom descends. Visa restrictions mean they cannot travel out of their region. Disillusioned by politics since the fall of the Milosevic regime in October 2000, many say they will not vote any more. Indeed, an opinion poll in June found only 48% of Serbs would certainly turn out in the next election; and 36% of would-be voters said they would back the hardline nationalist Radical Party.

The government of Vojislav Kostunica has been playing this for all it is worth. Trying to forestall the almost inevitable independence of Kosovo (see article), it has been warning foreign governments that, if Kosovo's Albanians win their independence, Serbia will be lost to the Radicals. Some liberals doubt this. A get-out-the-vote campaign would surely stop the Radicals, they argue. But that is not certain, says one pollster, Srdjan Bogosavljevic. Indeed, a big turnout might help the Radicals. If they came to power, they could not start a new war, he says, but they clearly do not have enough well-trained, modern-minded people to run the country well.

The best moment to hold an election has now become a hot topic. The liberal president, Boris Tadic, would like an early vote. He assumes that, if the poll is held before Kosovo is lost, pro-European and democratic forces stand a better chance of winning, weathering the ensuing storm and then resuming talks with the European Union on a deal that should be a first step towards membership. (Talks were suspended in May, after Mr Kostunica failed to keep a pledge to arrest Ratko Mladic, the Bosnian Serb ex-general wanted by the Hague war-crimes tribunal.)

But Ljiljana Smajlovic, editor of *Politika*, a daily, says that holding an election early would be a mistake. The democrats would have to run a campaign with an appeal that would implicitly amount to, “Vote for us and we will lose Kosovo for you.” Mr Kostunica, who perhaps realises that he cannot stop Kosovo's independence, is known to favour waiting at least until next year, probably the spring.

In the past few weeks Mr Kostunica has been spurred into an unusually energetic round of diplomacy. He has been to London, Washington and Brussels, where this week he presented an “action plan” meant to show that Serbia is genuinely trying to capture Mr Mladic—which not everybody believes. Officials in Brussels are also working on a set of incentives for Serbia to cushion the blow of what they see as the inevitable loss of Kosovo and, incidentally, to help beat off the Radical threat. But none of this may be enough to stop Serbia's slipping backwards.

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Kosovo's Serbs

Enclave trouble

Jul 20th 2006 | LIPLJAN
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Kosovo's Serbs worry about their future in an independent country

Get article background

WHEN elephants fight, the grass gets crushed. The old proverb is worth recalling before next week's "elephant round" of talks on Kosovo's future. Kosovo is part of Serbia and Vojislav Kostunica, Serbia's prime minister, says it will remain so for ever. Yet it is under the jurisdiction of the UN, which has been holding talks on its future since February. The elephant round would involve Kosovo's premier and president, Mr Kostunica and Serbia's president, Boris Tadic. If all four men turn up, their meeting will be in Vienna on July 24th.

Ethnic Albanians, who make up over 90% of Kosovo's 2m people, are sure that independence is coming. Yet it may not arrive by the end of the year, as they had hoped. Meanwhile, Kosovo's 100,000-odd Serbs are frightened and confused. More than half live in enclaves surrounded by ethnic Albanians; the rest live in a compact area abutting Serbia proper (see map). Although vehemently rejected by Kosovo Albanians, the idea that this bit might be hived off into Serbia is being discreetly floated in diplomatic circles.

Even if that does not happen, the north may get a special status. But that is little comfort for Serbs elsewhere in Kosovo. Clustered around the church in the town of Lipljan are some 800 Serbs, surrounded by 6,500 Albanians. Talks in Vienna have discussed decentralisation or effective autonomy for Serbian areas; but Lipljan has too few Serbs to make a viable Serb-run municipality.

One clue as to what keeps people there is the Serbian health centre, which has 400 staff, all paid by the Serbian government twice what they would get in Serbia proper. Serbia does this to keep Serbs and their families in Kosovo. If Kosovo became independent, say the nurses, they might have to go. Striking a patriotic pose, one says, "We are staying!" Others shout her down, yelling "You'd be the first to leave." The Serbian church in Kosovo is just as split: one bishop says that, if Kosovo gets independence, Serbs should leave, another says the opposite. Agim Ceku, Kosovo's premier, insists that he will do everything to "accommodate Serbs in Kosovo, but not Belgrade in Kosovo." But the Serbs do not trust him—or foreign promises that they will be safe.

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Charlemagne

The looming disaster

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Why the European Union faces a crisis with Turkey

"WHO lost Turkey?" asks Philip Gordon of the Brookings Institution in Washington, DC, mischievously.* The answer is nobody, so far. But if that wretched outcome were to transpire, top of the list of suspects would be the European Union in general, and the government of Cyprus in particular.

Because Turkey and the EU have managed to avoid a nervous breakdown twice in the past year—in October 2005, when Turkey's entry talks formally started, and again in June when the first stage in actual negotiations was rescued at the last minute—most Europeans (and Americans) have taken to crossing their fingers and hoping that everything will be all right on the night. But next time, it may well not be.

On the latest two occasions, everybody knew more or less what to do; it was merely a matter of summoning up the will to do it. This coming autumn, many people are either indifferent to the risk of a train wreck or seem unable to make the compromises that are needed to avoid it. All of Brussels knows that a crisis over Turkey is imminent; nobody knows how to forestall it.

The issue has become more complicated because things are going wrong both within Turkey and over Cyprus. To most Europeans, the big concern is that Turkey is backsliding on its commitment to liberal reform. An anti-terror law wending its way through parliament would make it easier to limit free speech. Almost 50 Turkish journalists face prosecution under the notorious article 301 of the penal code. After some improvements, relations with Kurds in the south-east have gone from bad to worse. And the government is busy undoing earlier changes to the country's public-procurement law to make it less transparent.

All of this is bad enough (and it will surely secure a harsh judgment of Turkey's progress towards European norms by the European Commission when it issues its annual assessment in October). The backsliding also helps groups within Turkey that oppose closer ties with Europe. These include many hawks, bureaucrats, judges and members of the security services, who all spot a chance to regain lost influence; and Islamists incensed by the European Court of Human Rights' decision to uphold Turkey's law banning headscarves in universities.

Worse still, these setbacks are only the most visible signs of a national lurch in the wrong direction that may prove hard to reverse. An ugly nationalism is growing, along with signs of religious intolerance. Support for EU membership has fallen by almost half from the level of two years ago. And for the first time in decades, Turkey's relations with both Europe and America are strained at the same time (tensions with America have risen since the occupation of Iraq because—in Turkish eyes—this has increased Kurdish assertiveness in the south-east).

With an election in Turkey due next year, there are now few votes in being pro-European and plenty in banging the drum of Turkish nationalism. Yet even that might be manageable were it not for the fact that the EU and Turkey are set on a collision course in the autumn: over Cyprus. The EU is demanding that Turkey open its ports and airports to all union members by the end of the year. Nothing unusual in that: Turkey has a customs union with old EU members and, if it wants to join the club, it must extend it to new members, too. Indeed, it has signed the treaty committing itself to this. But it refuses to ratify it right now, because of the circumstances of one new member: Cyprus.

Cyprus joined the EU in 2004 as a divided island. The government in the southern (Greek) part is officially recognised; the northern (Turkish) part is recognised only by Turkey, and is under a trade embargo. The Turks say it is unfair to ask them to open their ports to one part of Cyprus, while the other part is under an embargo—which sounds reasonable enough. The obvious answer would be for both sides to open up together: for Turks to allow air and sea access and for the EU to lift the embargo.

Island manoeuvres

However, reflecting the views of Cyprus (and of countries that dislike the idea of Turkish entry for other reasons and shelter behind Cypriot opposition), the EU insists that there is no link between the customs union and the trade embargo. Turkey, they say, is seeking membership; it has promised to open up its ports; it should now do it. After that, the EU might reconsider the trade embargo. That is legally exact, but it is not helping to overcome the division of the island. And, to the Turks, it puts the union in the invidious position of demanding that Turkey keep its word when it has not kept its own. In April 2004, when the two parts of Cyprus voted on a UN peace plan, the Europeans said that those who accepted it would be rewarded whereas those who rejected it would not. Yet the Greek-Cypriots (who rejected the plan) joined the EU anyway a week later, and are now in a position to veto Turkish membership. The Turkish-Cypriots (who accepted it) remain subject to an embargo, and have not had the money the EU promised them, either. The Turks feel betrayed over Cyprus and will not open up their ports before an election unless the trade embargo is lifted.

At some stage, a crisis over Turkey (and Cyprus) may be unavoidable. Turkey is a much tougher prospect to swallow than any previous entrant to the club. And, whereas in the period up to last October there was a clear and imminent deadline that all sides felt under pressure to meet, both the Turks and the EU know that the current membership negotiations are likely to go on for ten years or more. Even so, it would be better for the EU if the crisis were delayed until after the election, and was mainly about reform of the Turkish state, which most Turks favour, than having it now, before the election, and over Cyprus, where most Turks think the EU is in the wrong.

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* “Turkey on the Brink”. By Philip Gordon and Omer Taspinar. *Washington Quarterly*, Summer 2006.

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The Home Office

Man v machine

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A bold attempt to tame Britain's most troublesome department

SHORT of taking bribes or fornicating in a public park, there is no surer way to detonate a career in British politics than to accept a job as home secretary. Charles Clarke, the last holder of the post, was forced out in May after admitting that hundreds of foreign criminals who ought to have been deported were roaming the streets. The previous incumbent resigned in December 2004 after an affair involving a visa and a nanny. All of which might be expected to discourage John Reid, the current home secretary, from making too much of his department's failings. Yet that is precisely what Mr Reid has been doing.

Criticism of the Home Office has reached such a pitch that he may have had little choice. On July 19th an independent review launched by Britain's top civil servant found the Home Office to be in much worse shape than the three other government departments it looked at. The review faulted its leadership, management and systems, which does not leave much out. The head of a parliamentary committee added that its accounts were sloppier than a corner shop's.

Mr Reid's own diagnosis is even gloomier. He believes the Home Office's troubles are symptoms of an irreversible malaise that might be called late modernity. After the end of the cold war, he explains, people formerly held in check by totalitarian regimes began to move about—and, in some cases, plot crime and terror. The traditional family crumbled, along with old-fashioned notions of deference. This is bad news for a department charged with policing the nation's borders and salving its social wounds. As if poor management and bureaucratic failure were not enough, it turns out that history itself has been against the Home Office.

The history lesson is, of course, a way of laying blame somewhere other than at the department's door; but Mr Reid may be on to something. It is true that the collapse of communism (and the rise of ethnic nationalism) made people more footloose. The once-socialist state of Yugoslavia and its successors have sent over 40,000 asylum-seekers to Britain in the past ten years. These days, the most visible wave of legitimate migrant workers comes from Poland.

In some ways, though, history has turned in the Home Office's favour. The number of people seeking asylum has fallen steeply, from a peak of 7,000 per month in 2002 to 2,000 per month earlier this year.

Although asylum-seekers are only a small proportion of all immigrants, they take up huge quantities of official time and, because they are so unpopular, political energy.

The decline of deference notwithstanding, crime is down too (see chart). Figures released on July 20th showed that the average Briton is less likely to suffer a theft than at any point since the early 1980s. Muggings are up, thanks in part to the appeal of portable gizmos such as camera phones and MP3 players, but murders and serious woundings are in remission. Most importantly, for a government obsessed with how things are seen, people are less paranoid about crime in their neighbourhood.

All this means that the Home Office does not have to worry quite so much about the next day's scare stories. It now has a breathing space, which it plans to use reorganising. The famously sloppy immigration service will be reformed. Its head will take greater responsibility for her agency—if she keeps her job. So will those responsible for prisons and passports. The top management team is to be purged, and staff at headquarters sent to the operational coalface. Statistics, which often turn out to be flawed, will be sharpened. And that will leave Mr Reid and his ministers free to concentrate on the things that interest them.

Among them, it appears, are legislating and responding swiftly to public (for which, read journalists') concerns. Mr Reid's predecessor was not a populist, but David Blunkett, the man he succeeded, certainly was. No fewer than seven major criminal-justice acts were passed on his three-year watch, together with two immigration acts. For sheer energy, it was an impressive display, and one which Mr Reid already shows signs of emulating.

This week the home secretary unveiled a wish-list of measures that would, he claimed, “rebalance” the criminal-justice system in favour of the honest citizen. Among them were proposals to stiffen sentencing. If they are implemented, some serious offenders will no longer be considered for parole halfway through their sentences or given an automatic one-third discount for pleading guilty. He also wants to extend the use of Anti-Social Behaviour Orders, which are now used against nuisances such as noisy neighbours, to people suspected of organised crime.

Will another burst of legislative activity help people other than the home secretary sleep more soundly at night? Not according to the police. Although they rarely disagree with the laws that have handed them so many new powers, they are beginning to feel unpleasantly sated. Mike Craik, the chief constable of Northumbria police, says his officers have so many powers that they find it impossible to use them all, or even to keep track of what they are allowed to do. Others complain that training in new laws is distracting.

What senior coppers really want is a reorganisation of their own. Steve Finnigan, the head of Lancashire's police force, says serious, mobile criminals such as armed robbers and drug wholesalers are hard for a small force to handle, and likely to become more so. He was delighted when the Home Office said last year that it would encourage and even insist on mergers. But opposition from politicians and the media, together with financial kinks, ended the plan. Mr Reid promised much this week, but about police mergers he said only that they would be on hold for a while.

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De Menezes shooting

Most foul

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From The Economist print edition

The police are to be prosecuted—sort of

IT SOUNDED absurd, grotesque even. The two London police officers who pumped seven bullets at point-blank range into the head of an innocent Brazilian on his way to work a year ago are not to be prosecuted for murder or even manslaughter. Instead, the Crown Prosecution Service (CPS) announced on July 17th that it would bring charges against the Metropolitan Police as a whole under health and safety legislation—a law that is more commonly associated with clamping down on cockroach-ridden restaurants.

Describing the decision as “completely unbelievable”, the family of Jean Charles de Menezes, the 27-year-old victim, does not rule out bringing a private prosecution. This rare and expensive procedure was used (unsuccessfully) by the family of Stephen Lawrence, a black teenager stabbed to death in south London in 1993. Then too the CPS had said that it had insufficient evidence to prosecute.

The CPS's decision has been attacked from other quarters, too. Lord Harris, the chairman of the parliamentary group on policing, castigated the use of health and safety laws as “a ridiculous way forward” that would satisfy no one. Ken Livingstone, London's mayor, said he doubted that al-Qaeda would be “considering the implications for health and safety legislation when they are planning their terrorist activities”. The chairman of the Islamic Human Rights Commission, an advocacy group, said the refusal to bring charges against individual officers showed “the level of Islamophobia in Britain today”. Massoud Shadjareh based this on the fact that police mistook Mr de Menezes, a Catholic, for one of four Muslim terrorists who had tried the day before to blow up London's transport system.

Legally, however, the CPS had little option: it did not have enough evidence to be confident of convicting any individual involved. It judged that the officers had genuinely believed Mr de Menezes to be a suicide-bomber intent on destroying the Tube train. The CPS reached its decision after reading the (still unpublished) findings of a six-month inquiry into the fatal shooting by the Independent Police Complaints Commission, the first such investigation of controversial new guidelines that allow Britain's usually unarmed police to shoot dead—rather than incapacitate—suspected suicide-bombers.

Under those guidelines, reportedly first circulated in 2003 and never published, anti-terrorist police are instructed to aim at the suspect's head, rather than his body, to prevent him from triggering his explosive device. A recent review of police use of lethal force by the Association of Chief Police Officers concluded that the rules were “fit for purpose”. The Met is understood to be carrying out a separate review of its own “shoot-to-kill” policy.

The CPS is now bringing charges under section three of the 1974 Health and Safety at Work Act, the law used to prosecute Balfour Beatty and Network Rail over the Hatfield rail crash in 2000 in which four people were killed. It is, says David Leckie, a solicitor at Maclay, Murray and Spens, a “robust” tool. The act requires an employer “to conduct his undertaking in such a way as to ensure, so far as is reasonably practicable, that [third parties]...are not thereby exposed to risks to their health or safety”. Unusually for a criminal proceeding, the burden of proof is on the defendant: the Met will have to demonstrate that it took all “reasonably practicable” steps to prevent the death of Mr de Menezes.

Falling foul of the law can be expensive: Balfour Beatty, for example, was fined £10m ($18m), reduced on appeal this month to £7.5m. But as the defendant is a company or other legal entity—in this case the office of the Commissioner of the Metropolitan Police—no one goes to prison.

A summons was served on the Met on July 18th, with a first hearing fixed for August 14th. But the trial itself is unlikely to begin for six months at the earliest.

The courts will have to decide whether to delay the proceedings to allow for an inquest, an eventual private prosecution or both. Further delay is possible if the family decides to apply for a judicial review of the CPS's refusal to prosecute individual officers. Only at the end of all this legal flurry may the public finally learn how an innocent man came to be shot dead under a shoot-to-kill policy used for the first time outside Northern Ireland.

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Party finances

Less than meets the eye

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Why political parties are living beyond their means

IF BRITAIN'S two biggest political parties were companies they would be in trouble for trading while insolvent. On July 18th they handed over their accounts to the Electoral Commission, a supervisory quango. They show that Labour has the biggest hole to fill: at the end of last year it was left with general election-shaped liabilities of £27m ($50m). Paying this off would be easier if a couple of the people who lent the party money were not now demanding it back, after finding themselves caught up in what has become known as the loans-for-peerages affair. The involuntary trip to a London police station last week of the prime minister's fundraiser, Lord Levy, has not helped.

Labour's troubles would be more enjoyable for the Conservatives and Liberal Democrats if they were not in financial difficulty too. The Tories have a smaller deficit and the Lib Dems a modest surplus. But both parties have relied on funding methods that exploit loopholes in the rules.

The Conservative Party's accounts show that it was kept afloat through the election in 2005 by loans from supporters. Unlike Labour, the Tories have not disclosed who they all are, arguing that the money was lent on condition of anonymity. But it would not be a complete surprise if one or two of them had been nominated for seats in the House of Lords. Meanwhile the Lib Dems must wait for the outcome of a police inquiry into the finances of a firm called 5th Avenue Partners (whose founder is now awaiting trial) before the Electoral Commission decides whether the donation of £2.4m that it made to the party broke the rules on gifts from foreign firms.

Why are party finances in such a mess? First, because contributions from once-reliable sources have dwindled. Fewer people become party members; shareholders no longer let businesses give as generously as they did to the Tories; and Labour has deliberately reduced its financial dependence on trade unions. This has left parties dependent on wealthy individuals to pay for their election campaigns.

A second reason is that there are more elections to fight these days. In addition to local-government, European and parliamentary contests, the parties now have to fight elections to the Scottish and Welsh assemblies. “There are now major elections every year, but party funding still follows the general-election cycle,” says Justin Fisher of Brunel University. Instead of building up their war chests to fight a general election every four or five years, the parties now raid them all the time.

Campaigning, meanwhile, has become more expensive. Because parties can muster fewer volunteers to canvas door-to-door and lick envelopes, both Labour and Conservatives relied last year on call centres and automated messages. Only a fifth of voters received a visit from someone wearing a colourful rosette, according to the British Election Study. Labour even sent DVDs to undecided voters in target seats. As a result, both parties spent close to the legal limit on their campaigns.

The difficulty of matching income to spending in a way that does not make politicians look in thrall to a few wealthy donors has led all three main parties to call for more state funding and a lower cap on election spending. For the Tories, who argued until recently that state money would be pernicious, this is a significant shift. Andrew Tyrie, the Conservative MP who has shaped the new party line, thinks that large donations make voters suspicious of politicians and also sees changes to the party-finance rules as a chance to reduce Labour's bounty from the unions.

But a degree of state support is here already: in years when donors are not forthcoming, the main opposition party usually receives about a third of its income in government grants. Which, as Lord Levy knows, is a lot less fraught than having to ask people for money.

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Sport

Pay up, pay up and win the game

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The ruthless world of government funding

BRITAIN has contributed much to sport. It gave the world three of its most popular games (football, cricket and rugby), as well as an attitude towards playing them. Thanks to its public schools, it refined the idea of the gentleman amateur, blunting sport's competitive edge with the idea that taking part was as important as winning.

So it was odd to read this week a report from the Public Accounts Committee (PAC), a powerful parliamentary outfit that usually concerns itself with government spending, which questioned whether Britain was getting value for money from its financial support of elite, Olympic-level athletes. UK Sport, the body in charge of such things, spent £83.5m ($137m) over four years preparing for the Athens Olympics, but much of it seems to have been wasted. “Ten sports...won no medals, despite receiving nearly £14m in total,” noted the report, in the tones of a disappointed fund manager. It recommended that the offending disciplines have their funding cut by way of punishment.

UK Sport claims that the PAC's report was based on old information, and that it has already become even more ruthless than the committee proposed. Under its so-called “no compromise” approach, sports that do well will have their funding increased, while those that do not will be promptly cast aside. Cash will be doled out according to a formula that assesses both past performance and future potential, with money going to those who meet medal targets. “We're very much like a venture capitalist,” says a spokesman. “If you don't justify our investment, the money will stop.”

Such cold dedication to winning was once the province of communist countries such as East Germany, determined that their suspiciously manly female shot-putters would prove the superiority of dialectical materialism. Yet almost all countries now follow a similarly hard-hearted model, making sporting achievement at least as much a question of GDP as of individual talent.

Is the amateur ideal dead, even in the country most famous for it? “Oh yes, completely,” says UK Sport. “After we had our funding increased, the Australians went straight to their government to complain about it.” Let the new arms race commence.

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Canals

Messing about in boats

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A new look for an old network

CAMDEN LOCK, where Regent's Canal runs past a buzzing street market and skirts the open spaces of Regent's Park, was crowded last weekend in the middle of a summer heat wave. Its grassy verge was thronged as people lolled beneath the trees, beside the cool water and colourful houseboats. It is a fitting image of the revitalisation of Britain's oldest national transport system, bits of which date back to the late 18th century. British Waterways, the government-funded body that maintains 2,000 miles of Britain's inland waterways, reckons there are more boats on the network now than when it was used to ship vast quantities of heavy freight around a newly industrialising country.

The fortunes of Britain's canals waned with the rise of rail—quicker, and easier to build—and later the development of road transport seemed to seal their fate. For a while only the popularity of canal-boat holidays saved them from overgrown oblivion. “But in the late 1990s things really changed,” says Simon Salem, the marketing manager at British Waterways. “People got the idea that canals could be useful for regeneration projects, and we started to get funding from the National Lottery and the European Union.”

Now British Waterways spends much of its time doing deals with local governments and property developers, providing land for redevelopment projects and using the money it earns to improve the canal network. It has been involved in £2 billion-worth of projects over the past ten years, and aims to make the network support itself. Brindleyplace, which has reclaimed 17 run-down acres in central Birmingham, is held up as a textbook example of the regenerative powers of water. “Fifteen years ago the place was derelict,” Mr Salem says. “Now it's full of bars, clubs and restaurants.” There are other deals too, including a tie-up with Scottish & Newcastle, a big brewery and pub chain, to develop a network of riverside watering holes. A deal with Easynet, a telecoms firm, allows it to run fibre-optic trunk cables beneath its uncluttered towpaths.

The agency is using the money it earns from such ventures to upgrade its canals. It has reopened over 220 miles of disused canals, and its improvements to the current system range from low-tech hacking back of encroaching undergrowth to installing a brand-new computer system designed to regulate water levels automatically across the entire network.

Prettier canals improve the system's popularity with the public, and encourage tourists and visitors. But some people take things a stage further and forsake life on land for a floating home. One advantage is price: a modern and reasonably spacious canal boat sells for around £40,000, a quarter of the price of the average home on dry land. Nor is it necessary to sacrifice comfort for romance: “I've got a kitchen with a full-sized fridge and a washing machine, as well as a 12-foot lounge and a double bedroom,” says Beryl McDowall, chairman of the Residential Boat Owners' Association. “And I'm looking into getting broadband later in the year.”

Indeed, the growth in waterborne living is starting to strain the network's resources. “The big problem now is finding a mooring,” says Matt Ashmall of RoyScot Larch, a marine-finance company that offers loans to houseboat buyers. Many residents, unable to obtain a permanent berth, must engage in “continuous cruising,” staying at guest moorings for no more than two weeks at a time. This is inconvenient for those with permanent jobs.

Not all the changes are popular. One particularly nasty dispute is rumbling in Oxford, where British Waterways wants to sell a 160-year-old boatyard to developers keen to build flats there. Protesters had occupied the yard, lifting the boats out of the water and onto the land to frustrate the developers. They were evicted by bailiffs in May, but have vowed to fight on. Others are more phlegmatic. “There are big redevelopments all over the network,” says Mrs McDowall. “But I suppose the canals have to earn their

keep. And I'd rather see a sympathetic redevelopment than a long, slow decline.”

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The Tate

Sugared

Jul 20th 2006
From The Economist print edition

Recent purchases make the contemporary art world look cosy

AS A failsafe business plan it could hardly be bettered. Take one contemporary artist and one subsidised museum. Make the artist a trustee of the museum. Then encourage the latter to pay £600,000 for some of his pictures, without asking anyone outside how much they are worth. That, according to the Charity Commission, which regulates charities, is what happened when the Tate bought “The Upper Room”, a series of 13 canvases by Chris Ofili, who makes brightly-coloured paintings sprinkled with elephant dung. Yet despite the funny smell, the Tate may have got itself a good deal.

The paintings are the most important work by an artist who makes notably beautiful things and was one of the worthier winners of the Turner prize for contemporary art. According to the Victoria Miro gallery, which represents him, a single painting by Mr Ofili can now fetch £550,000. So the Tate may have secured 13 paintings for the price of one. The Tate adds that the Museum of Modern Art in New York also wanted the work, and that Mr Ofili reduced his initial asking price in an outburst of public-spiritedness.

Even so the commission's verdict is embarrassing for the Tate, for three reasons. First, it shows that the Tate has made a habit of buying work by its trustees, which breaks the terms of its various trusts. While plenty of them have been good buys (works by Howard Hodgkin and Patrick Heron, both former trustees, were notable bargains), it appears that on occasion the artists even stayed in the room while purchases of their work were discussed. In more regulated markets that might be called insider dealing.

Second, in October 2004 the Tate launched a campaign to persuade artists to donate their work. At the time, Sir Nicholas Serota, its director, argued that declining public funds would cause the museum's collection to atrophy unless artists and collectors agreed to give works to a grateful nation. If the Tate was so hard up, detractors ask, how could it afford to pay so much for one of its trustee's works just seven months before the appeal for donations?

Third, the arrangement between Mr Ofili, the gallery that represents him and the Tate was certainly too cosy. Sir Nicholas argues (probably rightly) that some secrecy about what the Tate pays for contemporary art has worked to its advantage, allowing it to undercut market prices regularly. But such deals are not motivated by artistic altruism alone. Having work displayed in a big public gallery boosts the value of the rest of an artist's output, so both Mr Ofili and the Victoria Miro gallery should benefit from the status conferred on him by Tate Modern. Moreover, some reports suggest that the Tate's purchase of Mr Ofili's paintings was financed in part by people who already own some of his work, which, if true, might just have the happy side-effect of raising the value of their investments too.

That Mr Ofili's representatives urged the Tate to speed up the purchase (the artist was about to get married, they said, and needed the cash) only reinforces the impression that the top end of London's contemporary art scene is run by a coterie of people with overlapping interests. Which, of course, it is.

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The Mini

Time to grow up

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From The Economist print edition

What Britain can learn from its pint-sized success

HELMUT PANKE, BMW's chairman, cheerfully admits that he never expected the company's launch of its Mini in 2001 to be much of a success. The car was a new take on an ageing British classic that was selling fewer than 12,000 units a year. Many thought it appealed only to baby-boomers trying to relive their youth. “There was a big debate in the sales department at the time,” he says. “We thought selling 100,000 would be a huge success.”

He need not have worried. Last year BMW's Oxford production line cranked out 200,000 Minis. It is expanding capacity by a further 20% by 2008.

The Mini's record is in sharp contrast to much of the rest of Britain's car industry. In April Peugeot said it planned to close a plant in the West Midlands, cutting 2,300 jobs. Soon after, General Motors reduced the number of shifts at its Vauxhall plant in Cheshire, in a move that many analysts think might foreshadow its closure too. Both cuts come a year after the collapse of MG Rover, which BMW bought in 1994 and then sold for a pittance after failing to turn it around. Nanjing Automobile, the Chinese company that bought MG Rover's assets last year, says that it plans to resume limited production of about 15,000 cars a year in England, and start making about the same number in Oklahoma, but move most of its equipment to China to produce 200,000 cars.

Why is the Mini prospering while so many other carmakers in Britain are moving to cheaper countries? Part of the reason is that BMW managed to create a new market segment with it, that of the upmarket small car. Even more surprisingly, says Bryan Nesbitt, the head of European car design for General Motors, it managed to do so in America, where status and car size go hand in hand. In part it did so by using some clever marketing techniques—for example, allowing customers to customise their own cars on the internet. Almost a third of them buy the results. It also made a virtue of producing and selling a more expensive car than its rivals.

Competing cars (such as the Fiat Punto Grande) sell for about a third less than the basic Mini model's £11,000. Fancier Minis are priced much higher, which means that BMW can afford British labour costs in return for the extra cachet that being made in Britain seems to give the brand.

The Mini's success has surprised BMW and has also presented it with a quandary. Unless the carmaker introduces new models to convert the Mini from a niche small car into a whole family of cars, it risks the same fate as Volkswagen's New Beetle or Chrysler's PT Cruiser. Both these retro-looking cars flew off dealers' floors when they were introduced but (partly because they were dogs to drive) were being sold off cheaply within three years in America.

The Mini will need as many as six different model lines over the coming years, its maker estimates. BMW has an enviably loyal customer-base—60% of existing owners buy another BMW compared with 30-40% recidivism rates for other carmakers—but Mini owners at the moment are likely to switch to other companies once they need cars to carry children. Although the new Mini is bigger than the original, only its most ardent fans are likely to install baby seats or use it for a family holiday. That may explain why the average Mini-buyer is 38 years old, while the BMW equivalent is 45.

What they really need, say Mini devotees, is the same thing with more room. So BMW has unveiled a concept car that hints at the return of the more spacious Mini Traveller. It and all other new models will be built in Britain, promises Mr Panke. If only other carmakers said the same.

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Bagehot

The fight over a big idea

Jul 20th 2006
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Both Tony Blair and David Cameron have fallen in love with the "third sector"

A CENTURY and a half ago John Stuart Mill observed that "one person with belief is equal to a force of 99 who have only interests". It seems that Tony Blair agrees. In May he wrote to Hilary Armstrong, the minister of state at the Cabinet Office, thus: "In many areas of public service delivery, the third sector has the potential for better user focus, better reach and better outcomes than the state, both in terms of service quality for users and value for money for the taxpayer." The prime minister went on to say that within a year he expected "a step change" in the provision of public services by the third sector, an umbrella term that covers everything from professionally managed not-for-profits to household-name charities and tiny, community-based social enterprises.

Last week, delivering his "hug-a-hoodie" speech at Iain Duncan Smith's Centre for Social Justice, David Cameron had his own gushing message. "You, the social entrepreneurs, the voluntary organisations—the people doing the patient, painstaking work on the ground...you stand for love," he told the audience.

The Tory leader, in the name of compassionate conservatism, and Mr Blair, in the name of public-service reform, are competing to claim what looks like more or less the same big idea. Their hope is that the "third sector" can come up with answers that have eluded the providers of state-run public services. Nothing is off-limits as far as Mr Blair is concerned. He wants to see the third sector deliver training for the hard-to-employ, rehabilitation for offenders, education, community care, even specialised health services.

For Mr Blair, the third sector's proven ability to operate "below the radar" of the state means that it can reach some of the hardest cases, win their trust and tailor services to their particular needs. A thriving voluntary sector, he believes, will help many of the poorer recipients of government services to regain a sense of power over their own lives.

Mr Blair is convinced that, damaging though the allegations of sleaze that currently dominate the headlines are, they are not the biggest political threat facing Labour. Come the next election, the government's ability to convince sceptical voters that it is not (or, at least, no longer) guilty of squandering countless billions of taxpayers' pounds on a failed model for delivering public services will be

of much greater importance. After realising that the key to improving services is to break up monopoly provision, ministers now see third-sector organisations as an important—and politically attractive—source of competition, innovation and localism. The stakes are thus high, and not least for the third sector itself.

No one in the government is keener on this approach than John Hutton, the work and pensions secretary. Impressed by examples in Australia, he would like the third sector to deliver a lot more of his department's programmes. To that end, he has asked his civil servants to ensure “competitive neutrality” in what he unflinchingly calls “the welfare-to-work market”. In other words, he wants third-sector organisations to compete for contracts on equal terms with the public and the private sector.

Mr Hutton sees the third sector made up not of bumbling do-gooders but of professionally run organisations that deserve proper incentives and rewards. He wants to end stop-go contracts that make it hard for them to grow, and he sees no reason why they should not achieve further economies of scale by operating across clusters of districts.

What neither Mr Hutton nor Mr Blair will admit is that they also see the third sector as a way of curbing the power of public-sector unions that frequently frustrate reform and hijack resources on behalf of their members. But Stephen Bubb, who runs Acevo, a body that represents about 2,000 charity and not-for-profit chief executives, worries that government will ultimately be held back by the fear of offending union leaders on whom the Labour Party is relying to repair its finances.

A former negotiator for the National Union of Teachers, Mr Bubb knows of what he speaks. Mark Serwotka, the left-wing leader of the Public and Commercial Services Union, whose members work in government Jobcentres, denounces ministerial enthusiasm for the third sector as “soft privatisation”. Labour's autumn conference in Manchester is certain to be the scene of a big row over Mr Blair's third-sector plans. With responsibility for funding the next election campaign falling to him, Gordon Brown may want to tread carefully.

Armies of compassion

The Tories have no such qualms. The notion that voluntarism and social entrepreneurship are inherently superior to the dead hand of state provision plays to the same sentiment as Mr Cameron's elegant riposte to Margaret Thatcher that “there is such a thing as society, it's just not the same thing as the state.”

According to Mr Bubb, however, the Tories' romantic attachment to an earlier era of charitable activism, often fired by moral and evangelical ardour, may lead them in the wrong direction. David Cameron has put Mr Duncan Smith in charge of policies to mobilise the third sector. But there is a whiff of 19th-century paternalism about the former Tory leader's “armies of compassion” that is at odds with the competent professionalism that third-sector organisations need to demonstrate when they become contractual partners of government.

As for the third sector, flattered though it is by the attention, it nervously wonders whether it can meet the expectations that are being loaded onto it. There are awkward questions about accountability, capacity and whether such closeness to government is compatible with maintaining its role as an advocate for causes. Being caught up in somebody else's big idea may turn out to be an uncomfortable experience.

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Executive share options

Dates from hell

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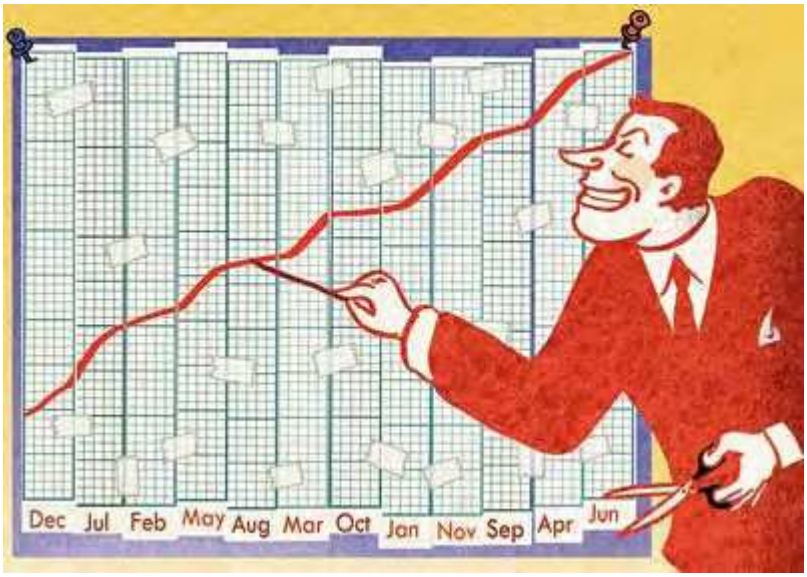

The scandal over backdated share options goes from bad to worse

Get article background

WHO would have thought that the reputation of America's corporate leaders—since the bankruptcy of Enron, seen as no more trustworthy than politicians or journalists—could fall any further? Yet that is what is happening, as the fuss over the backdating of executive share options intensifies with each day. The scandal began when academic research revealed the suspiciously fortuitous timing of option grants, a disproportionate number of which occurred just before a rise in the share prices of executives' companies. But it has since grown into a widespread investigation of corporate compensation practices that has the potential to put at least some people in jail.

The Securities and Exchange Commission (SEC) is now reported to be examining option grants at over 60 firms, and the number increases every week. Meanwhile, hundreds more companies are quietly conducting internal inquiries to see whether their option-granting processes were up to scratch. The scandal has touched well-known companies, including Microsoft, Apple and Home Depot.

Several firms have restated their financial results, to put right the wrongful accounting that followed backdating. Broadcom, a chip maker, says it will take a charge of at least $750m against profits it has reported since 2000. This is largely because share options dated at a quarterly low for the firm's share price in May 2000 were not in fact “completed” until later in the year, when Broadcom's share price was much higher. Unlike straight options, that immediate gain counted as “pay” under accounting rules at the time. It was thus a cost to be deducted from profits. This bizarre accounting treatment of share options clearly contributed to their popularity and to the use of backdating.

The scandal has cost several executives their jobs. Last week, the federal attorney in California's Northern District—which includes Silicon Valley, home to many of the option-addicted tech firms that are the focus of the scandal—announced a task force to focus on backdating. The first criminal charges are said to be imminent. Blaming “greed, slovenliness and unlawful conduct”, Harvey Pitt, a former chairman of the SEC, says backdating may have broken tax laws and corporate internal-control laws, including the Sarbanes-Oxley act, resulted in fraudulent corporate proxy statements, and even violated the Foreign

Corrupt Practices act, which among other things prohibits the falsification of documents to gain control of a firm's assets.

Behind the headlines, opinions differ about the extent of backdating, how much of it is criminal, and what to do about it. Ira Kay of Watson Wyatt, a compensation consultant, questions the statistical rigour of some of the academic analysis that has given life to the scandal. A recent study by two economists, Randall Heron and Erik Lie, found that some 18.9% of option grants supposedly made at market prices during the period 1996-2005 were backdated or otherwise manipulated to take advantage of favourable share-price movements. Such manipulation was done by 2,270 firms, or 29.2% of those in the sample.

Yet, argues Mr Kay, the study conflates two very different activities—actual backdating and the timing of options to take advantage of market-sensitive news about the company that the management knew was about to become public. Granting options shortly before announcing good news in this way is called “spring-loading”. Delaying a grant until after bad news is announced is called “bullet-dodging”.

Cooking the books

Whether there is anything wrong with spring-loading or bullet-dodging is much debated. Paul Atkins, an SEC commissioner, recently rebutted suggestions that such grants were really a form of insider trading. Boards may choose to time grants in this way for good motivational reasons, since options granted just after a jump in the share price or, worse, just before a fall, are less likely to inspire greater effort. But it is unclear whether shareholders knew that this was going on, and if not, whether they would have approved of it.

By contrast, backdating options granted later to take advantage of past share-price movements is clearly illegal, and always has been, says Brian Hall of Harvard Business School. “This is not a case of applying today's tougher standards to a different era when different rules applied,” he says. He expects the number of examples of such blatant criminality to be small.

Two factors contributed to the options mess. First, during the 1990s, options schemes were still in their infancy, and best practice was not as clear as it is today. Second, tech firms, in particular, were engaged in a fierce war for talent, at a time when share prices were extremely volatile, and private companies had greater flexibility in pricing options than public companies did. Offering to price options at, say, the monthly share-price low was useful in recruitment negotiations. In 1999, when it decided to stop pricing options at the monthly low, Microsoft faced questions from analysts about whether this would reduce its ability to hire the best brains.

What should be done? The SEC must decide how energetically to pursue a long list of offenders. Certainly, it should beef up its proposed new executive-pay disclosure regulations, says Kurt Schacht of the CFA Centre for Financial Market Integrity.

Two recent regulatory changes already seem to be having an effect. The Sarbanes-Oxley act, which requires option grants to be disclosed within 48 hours, has greatly reduced backdating, according to Mr Heron and Mr Lie—though an alarming number of firms are still not complying with the rule. Furthermore, proper accounting treatment of share options has removed the edge they had over other forms of equity-based pay, prompting many firms to reduce their use of options. Indeed, Microsoft went so far as to abandon them entirely in 2003.

According to David Zion of CSFB, an investment bank, the fair value of options awarded by S&P 500 firms fell from $104 billion in 2000 to $30 billion last year. There is reason to hope, then, that option backdating is one form of executive-compensation abuse that has had its day.

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Executive pay

Up or down?

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A debate over how much American bosses are paid

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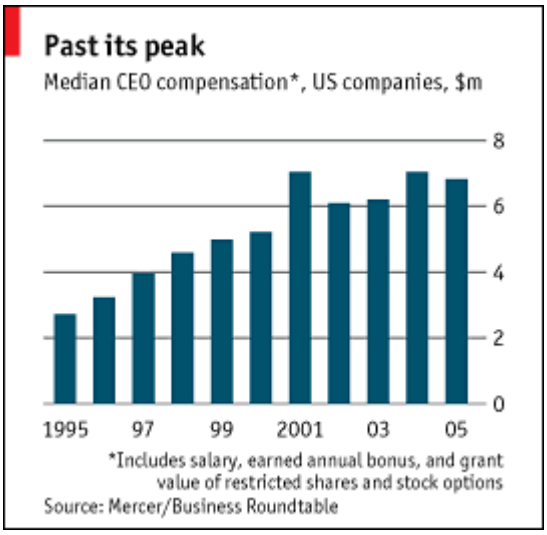

IT IS a rare trade association that boasts that its members are not paid as well as is widely believed. But that is exactly what the Business Roundtable, representing 160 chief executives of big firms, did this month. “Reports that large numbers of chief executives make hundreds of millions of dollars every year are simply untrue,” said John Castellani, the roundtable's president. “Executive compensation has closely followed the growth that companies have experienced in the last ten years.”

The compensation of the median chief executive of the 350 big firms in the Business Roundtable's sample fell to $6.83m in 2005 from $7.04m in 2004, and was lower than in 2001 (see chart). This finding has generated huge controversy. The roundtable has been accused of ignoring some valuable components of pay, such as pension benefits and dividend payments on restricted shares held by bosses, and of understating the value of options and other equity grants made to them. Add these in, and pay is still soaring, say critics.

Who is right? Steven Kaplan, an economist at the University of Chicago, calculates that measured ex ante (valuing options using the Black-Scholes formula, rather than by what they later turn out to be worth when they are exercised) and in real terms, for firms in the S&P 500 index, average chief-executive compensation peaked in 2000, and has since fallen by about a third. The only way to show compensation still rising is to combine forward- and backward-looking measures of pay in any year, a misleading statistical technique.

For the median chief executive, whose pay is significantly below the average, compensation peaked in 2001. Average realised compensation, based on a mixture of pay awards in current and past years, has also fallen from its peak in 2000, but the realised pay of the median boss is still rising, largely because options granted during the late-1990s bubble are still being cashed in.

Overall, executive compensation awards today are less generous than in the late 1990s, says Mr Kaplan—both because the financial value of the typical package is down and because an increase in the rate of turnover of bosses means that each can expect fewer years in a lucrative job. Still, even at today's levels, running a big American firm is nice work, if you can get it.

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Mergers in Europe

Let's try that again

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The European Commission's revamped merger policy is thrown into doubt

Reuters

IN ITS judgment, issued on July 13th, on the decision that led to the creation of Sony BMG, the world's second-biggest record company, Europe's Court of First Instance did not mince its words. The case presented by the European Commission in 2004 in favour of allowing the merger was "vitiated by a manifest error of assessment"; its arguments were incomplete and did not include relevant data. The verdict: the merger had been allowed on the basis of inadequate evidence.

The court's decision was an unexpected blow for the commission's competition division. In 2002 the Luxembourg court reversed three of the commission's decisions to block big mergers. This prompted Mario Monti (pictured), then competition commissioner, to revamp the merger-review process, and his approval of the Sony BMG deal in 2004 was seen as a test case for his new rules. The court's ruling last week—the first time that it has overturned a decision to allow a merger—has cast doubt on his overhaul.

The ruling gives Sony BMG three options. It can undo its corporate marriage, appeal against the court's decision or re-apply to the commission for approval of the merger. The company seems likely to choose the third. This means it will have to go through the entire clearance again, which will probably take nearly four months. Having been told off for not doing its homework properly, the commission is likely to embark on another in-depth analysis of the merger's effect on competition in the music industry.

The resulting uncertainty casts a shadow over future mergers, not just in the music business—EMI and Warner Music Group, two of Sony BMG's smaller rivals, also want to merge—but in other industries too. Firms in mature, highly concentrated industries, such as aerospace and commodities, will now think twice before attempting to merge. Competition lawyers predict that to avoid another embarrassing reversal in court, the commission will demand far more data from merging parties, placing a greater burden on companies and possibly prolonging merger talks. It will also take objections from third parties more seriously. The commission initially made light of the complaint against its clearance of the Sony BMG merger when it was lodged, 18 months ago, by the Independent Music Publishers and Labels Association, a lobby group that represents small record companies.

Will Neelie Kroes, Mr Monti's successor, now have to reform the commission's merger regime still further? Oliver Bretz, a competition lawyer at Clifford Chance, a law firm, says the British system, where an independent appraiser takes over from the Office of Fair Trading when a proposed merger requires in-depth analysis, might be one way forward for the commission. Or it could follow America's example and treat contentious merger projects as proper court cases. "The American system is not bad, but it is expensive," says Mr Bretz.

Yet aside from last week's reversal, Mr Monti's reforms have otherwise fared well so far. The appointment of a chief competition economist made the commission's merger scrutiny less legalistic. The so-called "fresh pair of eyes", an internal panel that plays devil's advocate in the review process, has improved the assessment of individual deals' impact on competition. A few weeks ago the commission was even named the world's most admired antitrust agency in the annual survey of the *Global Competition Review*, a trade publication.

So the court's judgment does not suggest that the new approach is inherently flawed, just that its application was insufficiently rigorous. "The ruling does not imply the reforms are not working, though we

may need to tweak them," says Jonathan Todd, Ms Kroes's spokesman. In a long session on a hot evening on July 19th, Ms Kroes and her department met for a post-mortem on the rebuff. One of the adjustments under discussion is to let the internal "fresh pair of eyes" panel have its say earlier, so its findings can be part of the evidence when approving or rejecting a merger. That would help to drive home the lesson from this whole episode: that the evidence used to support the approval of a merger needs to be just as diligently and rigorously prepared as the evidence used to justify a rejection.

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Online gambling

Out of luck

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An arrest signals America's intention to clamp down on online gambling

THIS was the week that David Carruthers's luck ran out. The British boss of BetonSports, a gambling firm listed in London, liked to boast that he travelled frequently to America and that he did not worry about getting arrested there, even though the country has outlawed his company's business—taking wagers on sporting events by phone and online. He should have known better. On July 16th, while changing planes in Texas, en route from London to Costa Rica, he was arrested by federal officials. The next day he was charged, along with 10 other people and four firms, with conspiracy and fraud relating to online gaming. BetonSports has since shut down 85% of its business. The surprise, says John Carroll, a lawyer at Clifford Chance in New York, is that Mr Carruthers evaded detention in America for so long. “I certainly wouldn't have told him it was prudent to travel to the US,” he says. “The law is unambiguously clear.”

The charges against Mr Carruthers mostly relate to alleged violations of America's 1961 Wire Act, which outlaws the placing of bets on sporting events via telephone and, according to more recent interpretations by the courts, via the internet. Mr Carruthers is not the first person to be charged under this law in recent years. Nor is he the first to argue that he had avoided breaking American law by basing his operations in countries such as Costa Rica and Britain, where such gambling is legal. In August 2000 Jay Cohen, an American, was sentenced by a federal court to 21 months in prison for accepting sporting bets from Americans, even though his operations were overseas.

The arrest of Mr Carruthers, a vocal campaigner for the legalisation and proper regulation of online gambling, is widely seen as a signal that the Bush administration is now taking a firmer line against an industry that has grown rapidly in the past few years. Just days before the arrest, the House of Representatives passed a law explicitly outlawing all online gambling, not just sporting bets, and prohibiting banks from processing payments to offshore casinos—though the law has yet to be passed by the Senate. “I don't think it is a coincidence,” says Christine Hurt, a law professor at the University of Illinois.

At the time of Mr Cohen's indictment, his firm was said to be taking in $100m-200m in bets each year. BetonSports, in contrast, took in nearly $1.8 billion in wagers last year, mostly from Americans. Mr Carruthers estimates that Americans placed more than $6 billion in bets via offshore sites last year. That is just over 7% of the $78 billion collected in 2004 by regulated American casinos, lotteries and other legal betting operators after paying out winnings. But the online industry is growing quickly.

Christiansen Capital Advisors, a research firm, estimates that last year global online-gambling revenues were almost $12 billion, up from around $3 billion in 2001. It reckons global revenues will double again by 2010. The growth has caused some to argue that America would do better to regulate its industry and tax the proceeds, rather than driving gamblers to use offshore sites. That is the approach adopted by Britain, which does not yet appear to have led to any great moral decay.

The arrest also highlights a glaring inconsistency in American law. Although America is strengthening its rules against some forms of online gambling, it allows others to flourish. Bets on horse races and online state lotteries are allowed by existing laws and are excluded from the tough new rules passed by the House. Such inconsistency suggests the clampdown on offshore sites is driven partly by the desire to protect people. Last year the World Trade Organisation ruled that America's practice of allowing state-authorised outfits to take online bets on horse races was inconsistent and discriminated against foreign operators. How very unsporting.

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Mining in South-East Asia

Sitting on a goldmine

Jul 20th 2006 | BANGKOK AND MANILA
From The Economist print edition

Can the region exploit its hidden treasures and keep locals happy, too?

METALS prices are sky-high, and countries with well developed mining industries are coining it. A new official forecast says Australia's export earnings from minerals will rise by 22% this year, to about A$62 billion ($47 billion). Its big, poor South-East Asian neighbours would also be earning billions if they had been quicker to exploit their vast, untapped reserves of ores. Mining firms, straining to meet soaring demand, are keen to invest heavily in the region. Governments in the Philippines, Indonesia and even isolationist Myanmar want them to come. But locals' doubts about mining, and their suspicion of foreign mining firms, run deep.

Opponents say mines often pollute nearby rivers and seas, damaging the livelihoods of farmers and fishermen; and local communities' rewards for running such risks are paltry, because most tax revenues from mining go to distant national capitals, and the profits disappear abroad. Such ill feelings erupted recently in Indonesia's Papua province, where police and troops were killed in clashes with protesters demanding the closure of a copper mine run by Freeport-McMoRan of America. The protests have damaged Indonesia's drive to attract more foreign investment. Similarly, the Philippine government's ambitious plan to bring in billions of dollars to develop 24 “priority” mining projects is under attack from environmentalists and the country's influential Catholic bishops.

The metals boom has recently been raging (see article) and, in a test of the Philippines' effort to exploit it, the government last week let a controversial mine on Rapu-Rapu island reopen on a trial basis. When it first opened last year, the Rapu-Rapu mine, with big reserves of gold, silver, copper and zinc, was the country's first foreign-run mine in nearly 40 years. But within months it was ordered to shut down after twice spilling cyanide into local waterways. The leaks, in a country with a history of pollution disasters caused by careless miners, provoked an outcry. Archbishop Angel Lagdameo, president of the Catholic bishops' conference, called for a “struggle” against all mining.

An official inquiry led by Arturo Bastes, another anti-mining bishop, said all mineral exploitation at Rapu-Rapu should be stopped until a detailed ecological study was completed. The mine's backer, Lafayette Mining of Australia, was already struggling financially, so any long delay in reopening risked causing its collapse. This would have alarmed the multinational companies preparing to invest heavily in the Philippines, including South Africa's Thistle Mining, Japan's Sumitomo, and BHP Billiton, an Anglo-Australian firm.

Determined both to push ahead with mining and to appease the greens and clerics, the Philippine government is letting Rapu-Rapu run for a 30-day trial period. It will be monitored by inspectors and will get its permanent licence back only if it shows it can operate without more spills. The environment ministry says it will put full-time inspectors into all big mines, tighten licensing and punish polluters more severely. Nelia Halcon of the Philippines' Chamber of Mines says the country's environmental rules meet international standards—but must be enforced.

What of the critics' other charge, that locals will not benefit? In fact, some locals are grateful for the well paid jobs that mining brings. As with the environmental worries, the way to maximise the benefits to locals is through better government. Mines, like other businesses in the Philippines, are granted tax breaks by various agencies that give little thought to their effect on government revenues. Corruption and inefficiency mean that tax compliance is poor. And the national government sometimes fails to give local authorities the 40% share of mining taxes they are due. Philippine lawmakers are now proposing bills to increase this share to 60% and to ensure the money is not held up in Manila. The government is trying to rein in the over-generous granting of tax breaks. It also hopes to increase revenues through competitive bidding for mining licences. But to encourage bidders, it needs some examples of profitable

new mines.

Mining firms must also try harder to respond to public concern. Lafayette's boss, David Baker, acknowledges that his firm failed to win the necessary “social licence” from locals, and that Rapu-Rapu's managers, then mostly foreigners, handled the pollution alerts badly, making it easier for activists to exaggerate the damage. A new, Filipino manager now runs the project.

Official estimates put the value of the Philippines' mineral reserves at $840 billion in 2002—almost double the country's GDP, and a conservative figure given today's inflated prices. To make the most of these riches, the government and the mining firms need to demonstrate that things have changed, and quickly—otherwise, by the time their new mines open, today's boom might well have turned to bust.

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Toys

Custody battle

Jul 20th 2006 | FRANKFURT
From The Economist print edition

A German dollmaker dithers in global tug of love

WHO will end up holding the baby: macho Japanese Power Rangers, or teenage Bratz from California? Either way, after several years of losses and other shenanigans, Zapf Creation—a toy firm from sleepy northern Bavaria best known for Baby Annabell and other realistic dolls—needs a strong parent.

On June 12th Japan's Namco Bandai Holdings, maker of Power Ranger figures, Tamagotchi digital pets and other toys, made a takeover offer through its German subsidiary of €10.50 a share, which Zapf's management and supervisory boards gratefully accepted. But the share price soon overshot that level, suggesting that another buyer was sniffing around. On July 6th MGA Entertainment, an American firm that makes Bratz dolls and other toys, said it had bought 18.05% of Zapf's shares and proposed a "strategic partnership".

AFP

Up for adoption

Now Zapf's bosses are split. The management board prefers Bandai's solid, unambiguous offer. The supervisory board, with the exception of its chairman, prefers MGA, even though MGA has contacted Zapf only once and has provided no clear plan. But if Zapf dithers too long—Bandai's offer expires on July 31st—Annabell and her sisters could be left on the shelf. That is not a healthy prospect for an ailing company that has been beset with management changes in recent months. Zapf has also had to restate its accounts for several previous years, and this week prosecutors began investigating Rudolf Winning, its former finance director, for suspected balance-sheet manipulation.

At last year's annual general meeting, a group of shareholders with less than a 5% stake managed to get three nominees voted on to the supervisory board, including its chairman. Now these men are at odds over the company's future, and have published their differing views on its website. None of them is prepared to recommend how Zapf's baffled shareholders should vote.

BaFin, Germany's financial watchdog, is watching closely. But as long as the protagonists stick to the letter of the country's peculiar takeover law—MGA need not explain itself unless it crosses a 30% threshold that triggers a mandatory bid—BaFin can do little to investigate. So far MGA has not even had to prove that it owns a single Zapf share. Is its offer a real one, or just make-believe?

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Airbus

Time for a new, improved model

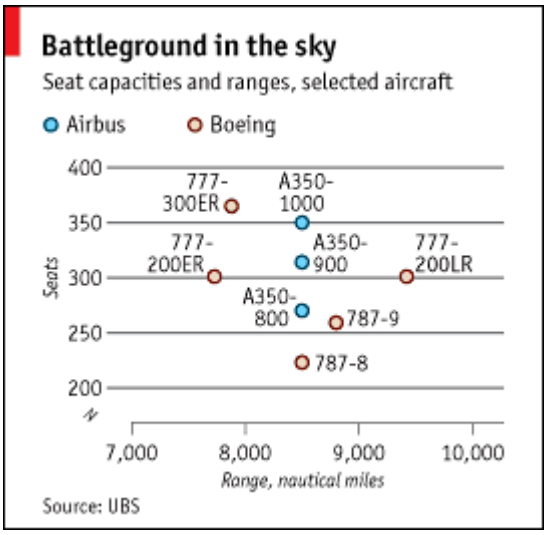
Jul 20th 2006 | BATH AND FARNBOROUGH
From The Economist print edition

AFP

Airbus gets to work on its medium-sized aircraft, but deeper problems remain

AS THE final assembly-line of its A380 super-jumbo in Toulouse ground to a halt and engineers scrambled to fix wiring problems, Airbus this week revealed its plans to close the commanding lead its American rival, Boeing, has taken in the aircraft market. Christian Streiff, the European firm's new boss, talked bombastically of doing “a vertical take-off with full thrust”. On the opening day of the Farnborough International Air Show, he unveiled three versions of its newly redesigned, wide-bodied A350 model. This aircraft, not the larger and more famous A380, is the key to restoring Airbus's fortunes.

After five years of trailing in Airbus's slipstream, Boeing has captured 75% of new aircraft orders this year, thanks to the superiority of its latest medium-sized, long-haul model, the 787. In various versions carrying between 220 and 260 passengers (see chart), this new Boeing has landed about 400 orders. As better engines extend the range of medium-sized aeroplanes, more long-haul routes between cities across the world are opening up, often bypassing hubs such as London or New York. So the market for medium-sized long-haul jets is booming, which is why the 787 is selling so well.



In response, Airbus has scrapped a $4 billion update of its successful A330 model in favour of three new, extra-wide-bodied planes called the A350 XWB, which will cost around $10 billion to develop. As well as adding to an array of aircraft names that is as baffling as a pilot's control panel, the new planes will feature wider cabins than comparable Boeing aircraft, and will carry between 270 and 350 passengers. Significantly, this positions the A350 to compete with two different Boeing models. The two smaller versions of the A350 will compete with the 787, but the largest version, the A350-1000, will take on Boeing's 777-300ER, a long-haul jet with a capacity close to that of the venerable 747-400.

Airbus had to abandon the original, more modest version of the A350 when its main customers complained that it was no match for the 787. Airbus, they said, should raise its game. Yet in doing so, Airbus finds itself competing not only with Boeing but also with some of its own models that have fallen short of expectations.

Normally, new aircraft have a product life of around 20 years. But not always. The warm-up act to the flying display by the A380 super-jumbo, star of the Farnborough show, was the four-engined A340-600, an aircraft that has been around for some four years. As the giant new airliner taxied for takeoff, the older A340 landed and then sloped off the runway with smoke puffing from its tyres. It seemed apt, given the A340's commercial fate. Airbus sold only 15 of them last year, whereas Boeing sold ten times as many 777s. High oil prices have sealed the fate of the four-engined aeroplane, along with rules that allow twin-engined aircraft to fly long-haul routes provided the nearest landing-strip is no more than two hours away. The A350 will thus eclipse the A340.

This is, however, a horrible time for Airbus to be launching such an ambitious new project. Because of the 12-month delay that has afflicted the new A380, the company already faces costs of around $2 billion. Rows over the handling of the problem have created management turmoil. Earlier this month Noël Forgeard, one of the two chief executives of the parent European Aeronautic Defence and Space company (EADS) had to leave, and Gustav Humbert, the chief executive of Airbus, resigned. Mr Streiff replaced Mr Humbert, and Louis Gallois, a Frenchman, replaced Mr Forgeard to join Tom Enders, a German, at the helm of EADS.

Mr Enders is the first to admit that the A380's wiring delays cannot be fixed overnight. He even concedes that things could get worse in the next few weeks. The hope is that final assembly in Toulouse can restart in mid-August. Airbus will report on its progress later this month.

Yet the problems with planning and production are symptomatic of deeper concerns at EADS. Its bicephalic structure—two chairmen, two chief executives—reflects its Franco-German origins and complicates decision-making. Nor is Airbus (still 20% owned by BAE Systems, a British firm, which plans to sell its stake to EADS) fully integrated into the parent company: it is like a state within a state. That prevents different divisions of EADS from pooling knowledge, says Mr Gallois. Airbus fails, for example, to tap the composite-materials expertise of EADS' spacecraft division. Meanwhile, the weak dollar means Airbus must cut costs to compete with Boeing. To overcome their crisis EADS and Airbus need new models not just in the sky, but on the ground, too.

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Face value

Thinking small

Jul 20th 2006
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Paolo Scaroni, an Italian oilman, believes big oil companies ought to be more humble

BIG Western oil firms are like addicts in denial, says Paolo Scaroni—and he should know, because he is the boss of the sixth-biggest, the Italian oil group ENI. The oil giants are trying to do business as usual, he explains, as if nothing is wrong. Yet they are, in fact, having trouble laying their hands on their own basic product. State-owned or state-controlled national oil companies (NOCs) are sitting on as much as 90% of the world's oil and gas, and are restricting outsiders' access to it. Worse, the best NOCs are beginning to expand beyond their own frontiers and to compete with the oil majors for control over the remaining 10% of resources. The first step in overcoming this predicament, Mr Scaroni declares, is admitting that it is a problem.

Not all oil bosses do. Rex Tillerson, the head of Exxon Mobil, the biggest private oil firm, insists that his company is not short of opportunities. David O'Reilly, who runs Chevron, another oil major, points out that despite a recent spurt of nationalism in Russia and Latin America, more of the world is open to firms like his nowadays than 20 years ago. With the price of oil high and with big oil firms chalking up record profits as a result, the oil and gas business hardly looks like an industry in crisis.

Most oilmen see the long-running battle between nationalist governments and foreign oil firms over the division of oil's spoils as the natural state of the industry. When the price is low, and money scarce, foreigners are welcomed for their access to capital and their ability to eke more oil out of the ground. When the price is high, and money abundant, their skills seem less useful and their fees more extortionate. But Mr Scaroni thinks that the battle is now over, and that the oil-rich countries have won. These days, he says, NOCs are capable of developing big, readily accessible fields by themselves—with a little technological help from service companies such as Halliburton or Schlumberger where needed. Even in countries where foreign oil firms still have a part to play, since the oil is hard to get at or the NOC inept, they are seen as supplicants rather than saviours, vying for the honour of extracting local resources.

So the majors must come up with innovative ways to make themselves useful. ENI is doing just that in Congo-Brazzaville, where it has developed several offshore fields that contain a lot of oil and a little natural gas. Other firms working in the country used to extract the oil from their fields and simply burn off the gas, since there was not enough of it to justify building expensive export facilities. But ENI decided to use its gas to fuel a power plant so as to reduce Congo's frequent power cuts. Better yet, it took the country's leaders to Italy to see similar plants of its own, to prove that it knew what it was

doing. Most of ENI's rivals, Mr Scaroni says, could not have done the same, since they do not run gas-fired power plants. More to the point, they are not sufficiently imaginative about endearing themselves to the governments on whose sufferance they operate.

ENI is also deep in negotiations with Gazprom, Russia's state-controlled natural-gas monopolist. For ENI to get hold of more gas to feed into its European distribution network, Mr Scaroni says, it will have to gratify Gazprom's desire to gain direct “downstream” access to customers in Italy. The deal has yet to be done—but it is clear that ENI will be offering more than the majors' normal enticements of money and expertise.

These tactics are not as new as Mr Scaroni suggests. The Italian government founded ENI after the second world war to break the oligopoly of the “Seven Sisters”—the majors of the day and the precursors of Exxon, Chevron, BP and Royal Dutch Shell. From its inception, it presented itself as a more reasonable, flexible partner than the overweening Anglo-Saxon oil firms. In its first big foreign venture, it offered Iran three-quarters of the revenue from any production there, rather than the standard half. ENI's boss at the time reportedly even floated the idea of marrying an Italian princess off to the shah to seal the deal.

Nor is ENI the only energy firm trying to ingratiate itself with oil-soaked governments and their NOCs. Wintershall, a German oil producer, and e.ON, a German utility, recently swapped shares in various downstream businesses for a stake in one of Gazprom's big gas fields. Both are also co-operating with Gazprom on a new undersea gas pipeline to western Europe, to the consternation of east European governments. Similarly, many observers contend that BP subscribed to the recent public offering of Rosneft, another Russian NOC, only because it hoped to win better treatment for its Russian ventures.

Oil and water

But Mr Scaroni takes this deference further than most. He is not at all offended, he says, by the notion that governments will increase taxes or tear up contracts to try to grab a bigger share of the proceeds of oil production when the price rises. The oil belongs to the countries concerned, he says, not to the oil firms that pump it, which must accept that they have no God-given right to the extra revenue. He does caution that governments should change existing arrangements by negotiation, not fiat. Indeed, he is in the middle of a row with the Venezuelan authorities about just that. But it is a far cry from oil bosses' usual rhetoric about the sanctity of contracts.

Then again, Mr Scaroni is a far cry from the usual oil boss. He has been in the business only a year. Instead of serving a long apprenticeship within his firm, as did his counterparts at Shell, Chevron, Exxon and BP, he moved to ENI from Enel, Italy's biggest utility, which he ran for three years after moving from Pilkington, a British glassmaker. He studied economics and management, rather than engineering. His relaxed, self-confident demeanour stands in marked contrast to the gruff, awkward bearing of many oilmen. A fitting messenger, then, for the idea that big Western oil firms need to change their ways.

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Japan's economy

Time to arise from the great slump

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EPA

As Japan emerges from an era of a zero interest rate, the country still needs to put more of its past behind it

Get article background

RARELY has a tiny change in interest rates been the subject of so much attention. When the Bank of Japan (BoJ) raised overnight interest rates to 0.25 % on July 14th, it was a tiny step and widely anticipated. But it was a giant leap for Japan, where the interest rate has been at zero for most of the past seven years. An interest rate of zero was chief among a range of occasionally desperate measures used to revive the world's second-biggest economy. So the rate rise is an acknowledgment that Japan is supposed to be back on the path to normality. Yet quite what normal is, no one is sure—the Japanese economy has been abnormal for so very long.

Japan's experience is unique. The country's decade and a half of stagnation stands in bleak contrast to the blistering growth that preceded it and that enjoyed more recently by many other rich economies, notably America. Japan is not alone in having had a banking crisis brought on when an asset bubble burst. America had its “savings-and-loan” mess in the 1980s. Sweden had a crisis like Japan's in the early 1990s. And in 1997-98, a financial typhoon tore through most of Asia. Yet in all these instances, action was, on the whole, fairly swiftly taken to write off bad debts, clean up banking systems and restore economies to growth. By contrast, Japan was mesmerised. For too long, instead of seeking to bring its financial system back to health, it appeared to place its hopes in great dollops of spending on public works to get the economy moving.

For consolation Japan can say that at least public confidence in its financial system never entirely collapsed—though it came close in 1997-98. Since a widespread run on bank deposits thankfully never happened, the depth of Japan's downturn cannot be compared to America's Great Depression of the 1930s. Still, the cost was great. As Michael Hutchison, Takatoshi Ito and Frank Westermann point out in “Japan's Great Stagnation”, not since the depression has any other economy experienced Japan's combination of wealth destruction, persistent poor growth, deflation and financial distress.

Japan was lucky. It began its long malaise as one of the richest societies on earth. But its subsequent performance was

abysmal. Between 1990 and 2005, real growth averaged just 1.3% a year. Without the malaise, Japan's GDP would have been about 25% higher in real terms than it is now. In nominal terms, Japanese GDP remains below its 1997 level, thanks to deflation (see chart 1). Over that same period from 1997, the nominal GDP of neighbouring South Korea, which bore the full brunt of the Asian financial crisis, has risen by 65%; America's is up by 50%. Japan's stagnation, then, represents a great squandering of wealth and opportunity.

The American plan

To understand why this happened and assess Japan's prospects as normality returns, you need to go all the way back to the end of the second world war. At first, Japan's American overlords wanted to rip up the bank-dominated system that had done so much to finance the rise of Japanese militarism—free capital markets and democracy seemed to American idealists, then as now, to go hand-in-hand. Yet by the early 1950s, with a cold war with the Soviet Union and a hot one in Korea, harder noses prevailed. What Americans wanted from Japan was a predictable flow of industrial goods. The Japanese, for their part, argued that banks were the best way to channel scarce resources towards industries that could help rebuild the economy swiftly. So banks, not capital markets, became the chief source of finance.

As Gillian Tett points out in her book, “Saving the Sun”, capital markets were not abolished completely; the Tokyo Stock Exchange reopened. Yet the point of shares was not to raise capital, but cement ties with other business groups in an interlocking set of cross-shareholdings. These groups, with a principal bank at their core, became known as the *keiretsu*. In this system, the strong carried the weak.

For a while it worked spectacularly. Banks, cosseted by protected markets, regulated interest rates and a maternal finance ministry took in households' cheap savings and channelled them towards chosen industries. Savers did not get much in interest, but back then the Japanese were nothing like the consumers they have become. Japan was making things chiefly for export. And the virtue of the system was that everyone had a job. Between 1960 and 1973 the economy grew by 9.6% a year, twice the OECD average. Unemployment, averaging just 1.3% over the same period, was well under half that of the rest of the OECD.

Even after the 1973 oil shock, growth averaging 3.8% a year, as it did up to 1989, was better than most. But by then Japan was bumping up against the constraints of a maturing economy. Creeping deregulation was eating into banks' protected markets at a time when demand for credit was no longer so great.

By the 1980s, Japan was the world's biggest creditor. But its current-account surplus had become a political thorn in relations with America. The Plaza Accord of 1985 was meant to pull the thorn by blessing a rise in Japan's exchange rate. In 1985-86, the yen rose from ¥260 to ¥150 against the dollar. Fearing that exports and the economy would slump, the BoJ repeatedly cut interest rates.

Red-hot property

Instead of weakening, the economy took off. The government plugged its budget deficit and the stockmarket shook off the Wall Street crash of 1987. Property markets blossomed, giving the banks a wonderful new source of lending. By the end of 1989, Japanese shares accounted for half the world's stockmarket capitalisation. Land prices soared. A value was famously put on the grounds of Tokyo's Imperial Palace equal to that of California. Then, on December 25th 1989, the BoJ decided to cool the party and raised interest rates.

The effect was bracing, as share prices fell and land dealings dried up. Japanese banks were unusually sensitive to the value of those assets. Four-fifths of bank loans were reckoned to be related to land, which was often used as collateral. Banks also counted as capital a good part of their equity holdings in other firms. As share values fell, so banks' capital levels were threatened. The system of cross-shareholdings began to work against them.

Yet for some four years an eerie calm prevailed. Optimism was still high that asset values would pick up again. Counting on a recovery, banks often lent more to distressed borrowers or tucked problem loans out of sight in subsidiaries. Bank regulators wanted to see no evil.

Only late in 1994 did a sense take hold that something was going badly wrong. Two poorly run Tokyo credit co-operatives had to be bailed out. More credit co-operatives failed and there was trouble at the seven *Jusen*, housing-loan corporations founded by the big banks. Their losses, reckoned to be ¥6.4 trillion ($68 billion), were more than the founder banks could muster. For the first time taxpayers contributed to a bail-out, to prevent contagion.

Yet the spreading crisis had already touched the country's big banks. Daiwa Bank, one of the biggest, lost $1.1 billion through a fraudulent employee in New York and was ordered by American regulators to close all its United States operations. A domestic problem, as Hiroshi Nakaso of the BoJ, recounts in a paper* on the crisis, now had an international dimension.

In the spring of 1997 the smallest of three long-term credit banks, Nippon Credit Bank, had to be injected with private and public capital. In the autumn a default by a middle-sized stockbroker, Sanyo Securities, paralysed the interbank market. Soon after came the failure of Hokkaido Takushoku Bank, the dominant bank in the northernmost island of Hokkaido, where it had lent billions against resort developments. Shortly after, Yamaichi Securities, one of the biggest brokers, abruptly collapsed. The BoJ supplied liquidity and what remained was later taken over by Merrill Lynch.

Japan's financial system appeared to be on the edge of a meltdown, like much of Asia's at the time. Reassurances were hurriedly made by the finance minister and the BoJ's governor, and by the following spring ¥30 trillion in public funds was made available as capital for troubled banks. Bad loans in the system were admitted to be at least ¥60 trillion.

The public injections may have been politically unpopular, but they seemed to calm things down—until the collapse of Long Term Credit Bank (LTCB) in the autumn of 1998. With assets of about $240 billion, this was among the world's biggest banks. As Ms Tett recounts, everything was done to prevent the problems coming to light, including dropping boxes of papers down manholes in the basement when inspectors called—not that the regulators wanted to find too much.

By the time of the collapse of LTCB, the scale of Japan's banking crisis had finally sunk in. Japan strengthened the system for deposit insurance. Public funds boosted the capital of the biggest banks and a newly created independent regulator, since renamed the Financial Services Agency, set out to break the cosy ties between banks and their former regulator, the finance ministry. In 1999 another injection of public money encouraged nine of the country's biggest banks to merge into four “megabanks”, which have since consolidated further into three.

This fresh start for the banking system should have been a fresh start for the economy, too. But the recovery never happened. In 2001, with recession again threatening, Junichiro Koizumi became prime minister on a reformist ticket. The following year fears of another crisis grew. As share prices fell, the BoJ announced plans to buy equities from banks.

In 2003 the government finally created a vehicle to clean up bad loans, although doubts about the motives behind this were widespread. And it was not until early 2005 that the banks could claim to have put their bad-debt problems behind them; they are now paying back the public money. After falling for a decade, net lending by banks started to rise again this year. And inflation, measured by “core” consumer prices, which exclude fresh food but include energy, has at long last turned consistently positive.

Why did the recovery not arrive earlier? One reason must be that, with the real level of non-performing loans in the banking system undeclared for so long, huge provisioning by the banks merely aggravated a state of financial disruption: banks could not afford to make fresh loans, even to good prospects. Another related reason is that until the banks had cause to deal with their loans, the troubled companies that had taken the loans out had little incentive to restructure. Japanese companies are now in much ruder health, but that is largely because of measures taken only in the past few years.

At the policy level, the government made two huge blunders. The first was to raise the consumption tax in 1997, which wrecked economic confidence. Just as confidence appeared to be recovering in August 2000, the BoJ declared an end to deflation and raised rates. The economy again went into a tailspin and the bank decided to retreat to zero six months later. But with prices falling, the expansionary effect even of a zero rate was lost, since real interest rates remained positive. A radical new measure was tried by

the BoJ: in effect, printing money by stuffing the accounts that banks hold at the central bank with free cash. That super-loose liquidity, known as “quantitative easing”, was withdrawn this spring.

Better prospects

The current economic expansion, which began in 2002, will by the end of this year be Japan's longest since the second world war. But not everyone takes its robustness for granted—the BoJ is constantly warned, by politicians especially, not to repeat its mistake of 2000. Richard Jerram, chief economist at Macquarie Research in Tokyo, points out that whereas the BoJ's favoured measure, core consumer prices, shows inflation running at 0.6%, other valid measures show prices still flirting with deflation. Strong uncertainties remain about Japan's potential future rate of growth, while a cushion is needed against external shocks, such as a slowdown in America or a financial crisis in China.

In the spring the BoJ published an inflation “range” of 0-2%, within which it felt comfortable with 1%. But that does not leave much room on the downside, Mr Jerram argues, when even a zero rate loses its effect once prices fall. Others are more optimistic. With inflation now at 0.6%, monetary policy is actually looser despite the rate rise than it was a year ago, when deflation plus the zero rate kept real rates positive. But on July 20th, in its latest survey of Japan, the OECD also warned the BoJ against raising rates too hastily.

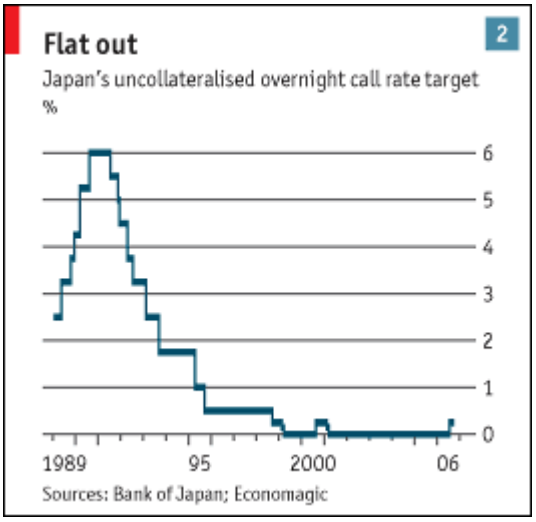
Reuters

It looks like brightening up

Jesper Koll, chief economist in Tokyo for Merrill Lynch, lists the ways in which the economy today is much stronger than it was in 2000—and well able to shoulder higher rates still. The yen has been weakening, not rising as it had been before August 2000. Bank credit is once again expanding, whereas it had been contracting in 2000. At the same time, borrowing costs have fallen, in real terms, as inflation has started inching up again.

Above all, the financial state of both companies and households is much healthier. Just as banks have cut their bad loans by four-fifths or more, so companies have brought their debts down to levels last seen before the bubble. Meanwhile, they make more efficient use of capital. Where once too many companies did too many things in different sectors, a brusque rationalisation has taken place, says James Ableggen, a business academic. Fourteen oil companies have been cut to four; seven cement companies to three, and 14 pulp and paper companies to three. More needs to be done in inefficient industries, notably electronics, where the temptation is to go back to the old over-investment and diversification. Nevertheless, Japanese firms are making record profits, and are investing to meet demand. With growth of over 3%, year on year, in the non-manufacturing industries, services look set to take up the running made hitherto by manufacturers.

Companies are also hiring. Between 1997 and 2003, employment fell by 2.4m, as people were either laid off or withdrew from the workforce. The trend has now firmly reversed, with unemployment at an eight-year low of 4%. Some reckon households have added about ¥100 trillion to their net worth since the 1990s. Since companies and households now have more financial assets than liabilities, higher rates should on balance be of benefit.



The prospect exists, in other words, for future growth of even more than the 2.2% the OECD now dares to envisage. No end of concerns remain. In particular, government finances are in a parlous state, at a time when the population is ageing and shrinking. The government has repeated its commitment to reduce the deficit, largely through spending cuts. At the moment, thanks to economic growth, the initiative has a fair wind with tax revenues higher than expected. But a new prime minister will arrive in September and this adds to uncertainty. Nor can today's robust GDP growth of around 3% be counted on for ever to fill the exchequer.

Last, there is the concern that Japan's new growth will be uneven. It is the biggest firms, including Japan's chief exporters, that have benefited most from a weak yen and a zero interest rate. Small companies struggled to get financial resources. A survey by the finance ministry finds that profit per worker at large manufacturers jumped from an annualised ¥1.6m at the end of 2001 to ¥5.4m at the beginning of this year, but at small manufacturers it has barely budged from ¥700,000. The picture at non-manufacturing firms tells a similar story. Yet large firms account for only one-sixth of total employment in Japan. Policymakers must watch carefully to see whether the new growth in bank lending benefits smaller businesses—a stated policy of the country's big banks.

This bifurcation is also apparent among the working population, where income inequality now stands above the OECD average. Growing inequality partly reflects Japan's rapidly ageing society, but many Japanese, particularly the young, have found it difficult to find full-time work, with the employment benefits that go with it. A recovering economy might temper this problem.

Now that the BoJ has raised interest rates, however, what comes next is a brave new world. The debate will rage about how much, and when, the BoJ should tighten further as monetary policy is “normalised”—financial markets appear to expect another quarter-point rise later this year, and half a point next year. But the importance of the BoJ's rate rise, and its earlier draining of its super-loose liquidity, is that private markets and not public charity will henceforth be supplying the credit that makes the economy go round.

Already, the private price of money, measured by bond yields, has jumped. The paradox, says Mr Koll, is that it may take yet higher rates to unlock money from private lenders, who want to be compensated for risks they are once again prepared to take. It will be a while before markets adapt, and a good deal of volatility can be expected on the way. At heart, though, a country where money is given out by the state for nothing undermines the standing of a market economy. And at least the BoJ has done something about fixing that.

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* “The financial crisis in Japan during the 1990s: how the Bank of Japan responded and the lessons learnt”. The Bank for International Settlements.

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Commodities

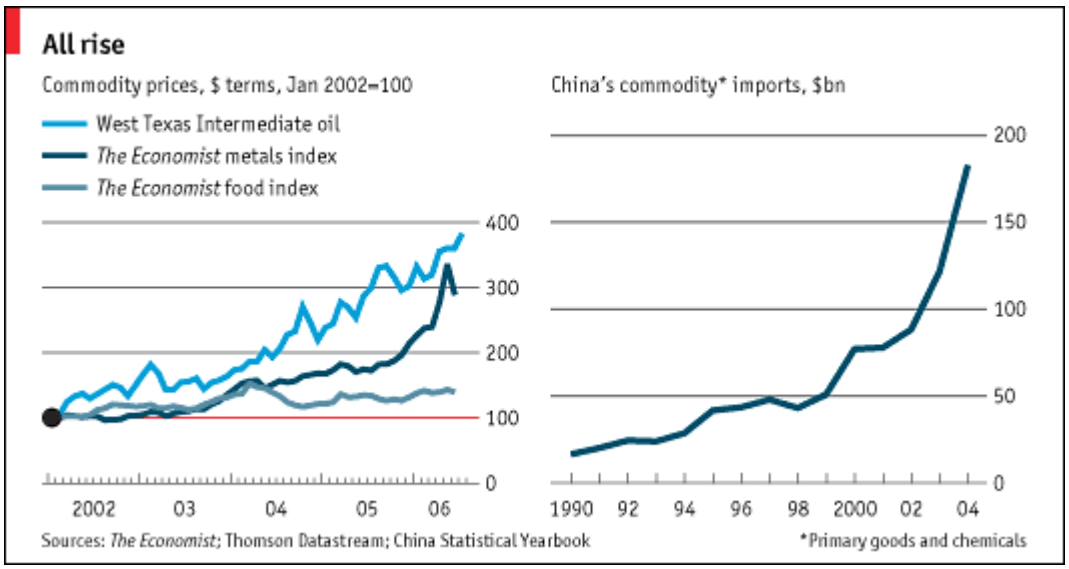
Oil that glisters

Jul 20th 2006
From The Economist print edition

How high can they go? Speculators love commodities right now. But what do the fundamentals say?

Getty Images

WHEN commodity prices slipped from their giddy highs in May, many observers hailed the beginning of an inevitable correction after four years of rapid ascent. But the markets, it turns out, were simply pausing for breath. On July 14th the price of a barrel of West Texas Intermediate oil reached a new record in nominal terms of $78.40, although it has since fallen a little. Nickel followed, topping $26,000 a tonne for the first time. Even some agricultural commodities are starting to get caught up in the boom. Rapeseed oil, for example, is fetching unprecedented sums. The price of food crops has risen by 40% since the beginning of 2002, although that increase is dwarfed by huge run-ups in the prices of oil and metals, as the left-hand chart, below, shows.



Some analysts believe that investors have inflated a speculative bubble in commodities. Hedge funds' investments in energy markets rose from $3 billion in 2000 to about $90 billion last year, according to the International Energy Agency, a think-tank. Trading of commodities at exchanges doubled between 2001 and 2005, according to International Financial Services London, an industry group. Over-the-

counter trade has risen faster still.

Other pundits think piling into commodities is justified, because the world has embarked on a “super-cycle”, in which commodity prices rise far higher and for much longer than is normal in a business blighted by frequent busts. The boom is certainly exceptionally long and lucrative. A recent report by Société Générale, a French bank, analysed five others since 1975. They lasted 28 months, on average, during which prices rose 35%. The present run, by contrast, has lasted 56 months, during which prices have doubled.

The super-cyclists put all this down to a simple mismatch between supply and demand. During the 1980s and 1990s, when commodity prices were low, mining and oil firms invested too little in new mines and wells, leaving them with little or no spare capacity. Although they are now rushing to increase their output, it takes years to find and develop new seams and fields. In fact, it takes longer now than it used to, because environmental regulations have become more onerous and activists more obstreperous around the world. With everyone trying to dig and drill at the same time, costs are rising and shortages of such things as huge tyres for mining trucks are hampering progress.

Meanwhile, on the demand side, the world as a whole, and China in particular, has been growing much faster than expected and consuming lots of raw materials as it does so. In the past 15 years China's imports of commodities have risen more than tenfold (see right-hand chart, above). One recent forecast, by Deutsche Bank, says that they will continue to grow by more than 10% a year for the next decade. At any rate, China's economy shows little sign of slowing. GDP grew at an annual rate of 11% in the first half of the year, according to official figures published on July 18th—the fastest pace in over a decade. This combination of feeble production and feverish consumption, the argument runs, means that demand for commodities will outpace supply for years to come.

But it is hard to apply this logic to all commodities. The supply of agricultural ones, for example, increases much more readily when prices rise, because farmers can plant more of them. Take maize (corn, to Americans) which is used both to make ethanol and to feed livestock. China's exports of maize are shrinking, as its herds multiply to cater to its citizens' growing appetite for meat. At the same time, the high price of oil is fuelling demand for ethanol, which is used as both a substitute for and an additive to petrol. Ethanol is expected to consume about a fifth of America's maize harvest next year. Both trends have helped to propel the crop's price to dizzy heights, with the prices of other commodities from which fuel can be made, such as sugar and rapeseed oil. But not for long: American and Chinese farmers are already planting more maize.

Gold is another exception. It is dearer than it has been for decades, yet jewellers and industrialists would need years to use up all the world's stocks. Gold is valued not for its scarcity, but as a hedge against inflation. Its price has duly risen, as worries about inflation have grown (thanks partly to the expense of oil) and central banks have raised interest rates. Higher interest rates, however, should eventually slow global growth, and so crimp demand for other commodities. The prices of gold and more mundane metals may therefore start to move in opposite directions.

Not even oil, the archetypal industrial commodity, quite conforms to the super-cycle theory. Granted, consumption continues to rise, especially in China, where imports have grown by about 10% so far this year. Furthermore, the industry can muster only about 1.5m barrels a day of spare pumping capacity—a tiny fraction of the 84m-odd barrels the world consumes daily. That makes the price sensitive even to relatively minor interruptions in supply. Iran, which exports 3.4m barrels a day, has threatened to use oil as a weapon in its disputes with America and the European Union. So oil traders twitch every time the two sides exchange barbs.

Nonetheless, during the past year spare capacity has actually increased marginally, as have stocks. This cushion should expand further over the next couple of years, as production starts from oilfields now being developed. Meanwhile, there are signs that demand, although not falling, is growing more slowly in the face of high prices. Supply and demand will certainly remain finely balanced for several more years, but the outlook is improving for consumers—even if this is not yet detectable in the price of oil.

It is hard, concedes Frédéric Lasserre, the author of Société Générale's report, to translate nebulous fears about future supply into prices. In the long run, the price of any given commodity should revert to the cost of producing an incremental unit of supply. By that measure, Mr Lasserre calculates, oil is overvalued by 50%, and zinc and copper by almost 40%. In the short term, the level of stocks plays an important part. But again, relative to the historical relationship between stocks and prices, Mr Lasserre reckons copper is 148% too dear; zinc, 122%; nickel, 70%; and oil, 49%.

Other analysts see parallels with the dotcom bubble of the late 1990s. After all, plenty of people are opining that “things are different this time”. Pension funds and individual investors are keen to get in on the action. CalPERS, America's biggest pension fund, is due to decide soon whether to put money into commodities. If such a conservative operator is eyeing commodities, cynics say, then a correction must be close at hand.

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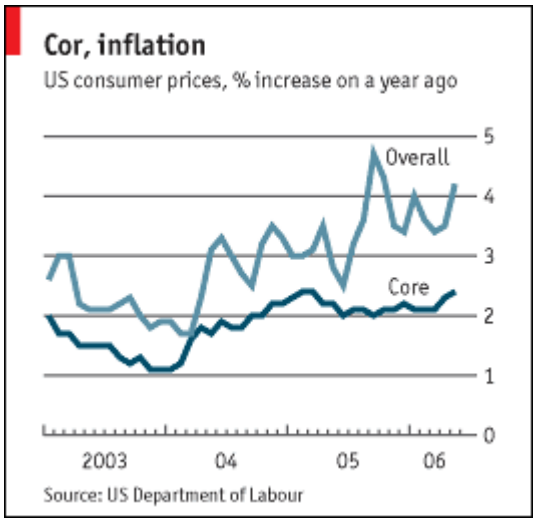
American monetary policy

Making sense of Bernanke

Jul 20th 2006 | WASHINGTON, DC
From The Economist print edition

Inflation data point one way, but the Fed chairman seems to point the other



THE circumstances were not auspicious. Less than two hours before Ben Bernanke, chairman of America's Federal Reserve, made his semi-annual report to Congress on July 19th, new data showed that American inflation, yet again, was unexpectedly high. The core consumer-price index (CPI), which excludes food and energy, jumped 0.3% in June and is now 2.6% higher than it was a year ago, well above the maximum with which Mr Bernanke is thought to be comfortable.

Given the fuss that he and his colleagues have recently made about such “unwelcome” rises in inflation, many economists expected a nasty June inflation report to seal another rise in short-term interest rates when the central bankers next meet on August 8th. Michael Prell, a former head of research at the Fed, said a 0.3% inflation figure would make it “hard” not to tighten. And that is exactly what financial markets expected—for about 90 minutes. After the CPI figures were released, futures markets raised their expectation of an August rise from 60% to 90%.

Pretty soon, however, Wall Street had a wholly different view. Share prices rose and bond yields and the dollar fell as investors listened to Mr Bernanke and decided the Fed might not tighten policy much more after all. Judged by the futures market, the odds of a rate hike in August fell back, ending the day at around 70%.

Was this another flip-flop from a man who has developed a reputation for confusing financial markets by sounding alternately hawkish and dovish? Or was Wall Street reading too much softness into the Fed chairman's comments?

The answer is a bit of both. Mr Bernanke's testimony was carefully balanced. He repeated his line that recent rises in inflation are “of concern” and he told lawmakers several times that unexpectedly high inflation was the single biggest risk to America's expansion. He was fairly optimistic about growth. Although the housing market was slowing, Mr Bernanke pointed out that other areas, including exports and non-residential construction, were picking up. His forecast was that the economy would slow, but to roughly its trend rate of growth. This was not a testimony, in short, that ruled out further rises in short-term interest rates.

But nor did Mr Bernanke show any signs of panic about inflation. Quite the opposite. There was no mention of June's consumer-price figures. The updated economic forecasts published alongside Mr Bernanke's testimony show that the Fed expects inflation to slow, but that for at least the next 18 months consumer-price inflation will remain higher than the central bankers forecast in February and, most important, above their informal target of between 1% and 2%. The Fed now expects its preferred inflation gauge, the deflator for personal consumption expenditures excluding energy and food, to rise by 2.25-2.5% this year and by 2-2.25% in 2007. No sign there, in other words, that the Bernanke Fed is in any great hurry to get inflation back within range.

If Mr Bernanke's aim this week was to create room for manoeuvre and give the Fed the option to pause in its rate-tightening, he achieved it—but at the price of some coherence. If the economy is slowing only modestly, as his words suggested, his relaxed attitude to inflation seems odd, especially after recent

months' inflation figures.

One possibility is that Mr Bernanke is less bullish than he lets on. The Fed has lowered its expectations for GDP growth in 2006 to 3.25-3.5%. That implies a sharp slowdown in the second half of the year, to a rate well below 3%. The other is that he is simply not worried enough.

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Rosneft's share offering

Sergei pulls it off

Jul 20th 2006 | ST PETERSBURG
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The flotation, at home and abroad, of a Russian oil giant

AFP

A VIOLENT rainstorm broke as Sergei Bogdanchikov, boss of Rosneft, Russia's state-run oil firm, was defending his company's initial public offering on the margins of the G8 summit in St Petersburg. But apart from that heavenly wrath, he and his firm seem to have got away with it. On July 18th a London court dismissed a blocking plea by Yukos, whose main asset was acquired by Rosneft through a forced and rigged auction in 2004 and now provides about two-thirds of Rosneft's production. That enabled full trading in London to begin the next day; it had started officially in Moscow on July 17th.

Or did they get away with it? Rosneft's was the biggest listing in Russian history, raising $10.4 billion. At $7.55 a share, the price was almost at the top of the range the company had set—bringing in more than enough cash to pay off a big debt for Rosneft's state-owned holding company, which was part of the rationale for the listing. But arguably this was as much a private offering as a public one. Half the shares went to four buyers: BP, which splashed out $1 billion; CNPC, a Chinese state oil firm ($500m); Petronas, of Malaysia ($1.1 billion); and a mystery fourth, acting through Gazprombank. (ONGC, an Indian oil firm, may also buy in soon.) Mr Bogdanchikov insisted the offering would have been fully subscribed, even without the foreign oil firms, but take-up by foreign institutional investors was relatively slim. Friendly Russian tycoons and banks were said to have been pressed into service.

Foreign investors were deterred by the litigation risks (not over yet), the dangers of political interference that the prospectus spelt out (the interests of the state, it said, “may not coincide with those of other shareholders”) and the inexperience of Rosneft's management. The price made no allowances for these worries. Rosneft began trading at a premium to Lukoil, Russia's biggest oil firm by production.

The oil companies that subscribed, however, had good reasons for doing so. Buying a piece of Rosneft lets them increase the reserve figures on their books. More important, since foreign oil majors can hope to prosper in Russia only with the collaboration of state-run partners, ingratiating themselves with Rosneft and the Kremlin may help with future opportunities for joint projects—or with existing ones: BP has hitherto faced long delays in extracting gas from the giant Kovykta field that it co-owns in Siberia.

The big buyers' insensitivity to price left Rosneft with an implied capitalisation of $79.8 billion, the

highest in Russia after Gazprom, the state-run gas giant. The price fell a bit at first in Moscow, but the smallish free float should help keep it stable. In the longer term, Rosneft's privileged access to new production licences and likely acquisition of Yukos's remaining assets when it finally goes under, may justify its valuation. But it has not yet persuaded everyone that it can become the world-class energy firm that Mr Bogdanchikov, and the Kremlin, want it to be.

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Stockmarket listings

In search of cheap money

Jul 20th 2006 | NEW YORK
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Finding the best place to issue shares is getting harder

AMONG the heads of foreign companies listed on American exchanges, there is a broad consensus: America's legal environment is increasingly toxic and has only been worsened by the onerous provisions of the Sarbanes-Oxley act. At the same time, American exchanges' advantages in transaction costs have narrowed substantially. Were it not for equally despised laws preventing companies from delisting their shares, many foreigners would be gone in a moment.

Not surprisingly, new listings of foreign companies are down. Big deals that would once have come to New York have gone elsewhere—notably the offerings of shares in London this week by Rosneft, a Russian energy giant (see article), and in Hong Kong in June by Bank of China, the country's third-largest bank. Coming up is another enormous offering, from Industrial and Commercial Bank of China, which once would have already had a ticker symbol reserved for it on the New York Stock Exchange but is now destined for Hong Kong and London.

However, not all companies are turning their backs on America. The benefits can still outweigh the costs of regulation and litigation. The most encompassing example can be found near Wall Street, in offices once occupied by E.F. Hutton, a once-grand broking firm now consigned to history. Bank Hapoalim, Israel's largest financial institution, has begun the laborious process of building a full-service investment bank. It hopes to apply to the Federal Reserve for permission to underwrite equity offerings. Bank Hapoalim is setting up shop in America because that, to a large degree, is where Israel has outsourced its capital markets.

There are 114 Israeli companies listed on top American exchanges, mostly on NASDAQ. Their collective market value, at $115 billion, is just below that of the whole Israeli stockmarket. John Murabito, head of Bank Hapoalim's American operations, reckons that another 50 Israeli companies are ready to go public, or soon will be, and are all good bets to list in New York. Those already listed will be back for all the usual kinds of financing companies need, and to take part in mergers, as either buyers or sellers.

The advantage of America for these companies lies not in politics (though being spared boycotts helps) but in the businesses they are in: by and large, high-technology stuff. America has a huge retail and institutional investor base for such companies, with armies of clever analysts and investors willing to throw money at promising ideas and pull it out of others. Not only Israelis are keen. Although Asia's big banks may be shunning New York, the continent's technology companies keep coming. This year, even though aggregate new offerings are well down, NASDAQ has had new listings from Taiwan, Singapore, South Korea and even China.

A more complex question is whether companies that not in specialised niches can raise more listing their shares in the American markets than they would elsewhere. The search for a market that pays the highest price has historically been elusive. In the 1980s many foreign companies listed in Japan, hoping that they would benefit from the exorbitant valuations then common for local firms, only to find that prices were set back home. Increasingly, impediments either practical or legal that prevented global fund managers from buying directly in local markets have disappeared; inevitably, as more go overseas, prices smooth out between markets.

There may, however, be some more subtle benefit from listing in a demanding market. A paper published in 2004 by Michael Weisbach, a finance professor at the University of Illinois, concluded that foreign companies listing in America found it easier to raise money at home. Research by Andrew Karolyi, of Ohio State University (who advises the New York Stock Exchange), and others finds that when foreign companies list in America, more analysts start covering them, and the extra transparency and higher

governance standards demanded by American law helps their share prices. An article in this month's *Journal of Financial Economics* by Mr Karolyi, Warren Bailey, of Cornell University, and Carolina Salva, of the University of Bern, suggests that once foreign companies list in America, their share prices are more volatile at the time of earnings announcements. This, think the authors, may indicate that investors take the results more seriously.

Even so, the benefits could still be overwhelmed by the costs of onerous rules. The critical step is getting the balance right. Fail, and eventually, everyone loses.

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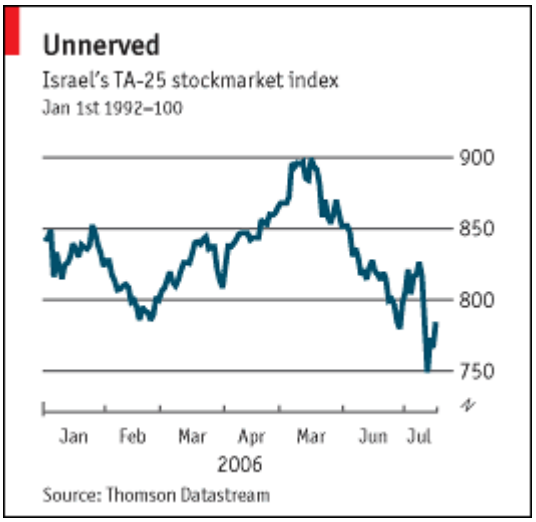
Counterterrorism and stockmarkets

A calculation of conflict

Jul 20th 2006
From The Economist print edition

When is counterterrorism counterproductive? Ask the stockmarket



THE decline in the Israeli stockmarket as Israel's conflicts with Hizbullah and Hamas have intensified—9.4% between July 10th and July 13th, though it has revived since—may reflect more than the expected financial response to unrest and uncertainty. If a recent study of the Tel Aviv Stock Exchange is any guide, Israel's targeting of Palestinian political leaders in response to the capture of its soldiers has been counterproductive. Although Israel's army says it has been careful to minimise casualties during its latest incursions into Gaza and Lebanon, a study* by Asaf and Noam Zussman, brothers and economists at Cornell University and the Bank of Israel respectively, shows that the stockmarket's reaction to counterterrorism favours attacks on important militants rather than on political leaders or low-ranking militants.

An analysis of more than 100 assassination attempts carried out by Israel between 2000 and 2004 shows that the Tel Aviv 25 index dropped by an average of 1.1% in response to an attempted assassination of a Palestinian political leader. The killing of a Palestinian leader from the military wing led to a 0.6% increase in the stockmarket. The market reaction to a large terrorist attack against Israel brought an average drop of 1.2%—a response only marginally greater than if Israel killed a Palestinian politician.

The stockmarket is an appealing indicator of the effectiveness of counterterrorism measures because terrorism damages the Israeli economy and the market gauges public perception of the news. The goal of Israel's strategy of assassinating leaders is to weaken the capabilities of their organisations without inspiring further attacks. The study concludes that eliminating leaders in the military wing of an organisation is most productive, as these people recruit and train terrorists and plan attacks. Their deaths are a drain on the organisation's resources. Those on the political wing tend to be spiritual, social or political leaders, and attacks against them motivate future violence because they are seen by Palestinians as actions that break the rules of engagement.

Some industries, such as security, benefit from an increase in terrorist attacks. But counterterrorist actions have had a wider impact on the Israeli economy. The effects on the market are not just ephemeral, emotional responses that disappear in a day. The study finds that they can linger for weeks. The violence in Lebanon remains so volatile and fluid, says Asaf Zussman, that it is difficult to divine what the market's initial response means.

Perhaps surprisingly, the assassination study shows that both sides of this coin look alike. The Palestinian stock exchange's Al-Quds index reacted similarly to the Tel Aviv 25, probably because the Palestinian economy is so closely tied to Israel's. Perhaps behind those common numbers is common ground: investors on both sides see that a capable Palestinian political leadership remains in the best interest of both.

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* "Assassinations: Evaluating the effectiveness of a counterterrorism policy using stockmarket data". *Journal of Economic Perspectives*, Spring 2006

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America's corporate pensions

On the runway

Jul 20th 2006 | NEW YORK
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At last, pension reform is in the works

PERSUASION is often a subtle art, but not always. On July 18th hundreds of employees of Northwest Airlines descended on Washington, DC, to urge Congress to hurry up and pass a bill on company pension schemes—with special terms for their industry. Without this, averred Doug Steenland, the bankrupt company's chief executive, Northwest might have to cancel its retirement schemes. Two other bankrupt carriers, United Airlines and US Airways, have already broken their pension promises. Last month another, Delta Air Lines, said it wanted to ditch its pilots' pension plan.

The stakes are high, and not just for employees. The obligations of the stricken airlines will be picked up, in part, by the Pension Benefit Guaranty Corporation (PBGC), the quasi-governmental insurer of America's company pension plans. But the PBGC's own finances have crumbled. Its assets exceeded its liabilities by $10 billion in 2000, but now it has a $23 billion hole. United alone dumped over $7 billion in unfunded obligations onto the agency.

To put the PBGC on a sounder footing, both houses of Congress passed bills last year. Broadly, both called for companies to pay higher premiums to the PBGC, stricter funding rules for pension plans and better disclosure. After four months of haggling over details, a compromise between the two houses is said to be imminent.

Help for airlines has been one of the main areas of argument. It is likely that the industry will have up to 20 years to make up pension shortfalls; other companies will have only seven. Only two years ago, in another election year, Congress passed a law that let employers sidestep over $80 billion in pension contributions. The companies with the most severe pension deficits—mostly steelmakers and airlines—received an extra $1.6 billion of “relief”, to little apparent effect.

However, the pension problem goes far beyond airlines. Standard & Poor's (S&P), a rating agency, reckons that American corporate pensions are underfunded by about $140 billion, even after taking into account recent increases in interest rates (which reduce the present value of future pension liabilities). Even if interest rates rise further, other factors, such as earlier retirement and longer lives, will remain.

And then there is the question of how to report the funding gap. Quite separately from Congress's wrangling over premiums and relief, America's setter of accounting standards, the Financial Accounting Standards Board (FASB), is revamping its rules for valuing pension plans. Today's rules result in financial statements that are “misleading and meaningless”, according to David Zion, of Credit Suisse. Companies are allowed to smooth the (often volatile) value of their pension assets and liabilities—but at the expense of clarity. In 2005, for instance, companies in the S&P 500 share index reported that pension assets outstripped obligations by $121 billion. Mr Zion says their plans were underfunded by $145 billion.

FASB proposes that companies put on their balance sheets the difference between the value of pension-plan assets and the present value of their obligations, a number that is now tucked away in footnotes. Although arguably a fair reflection of the state of pension schemes, the proposed rule could make balance sheets much more volatile, because the lion's share of American pension-plan assets is invested in shares.

For many years defined-benefit (DB) plans, in which companies promise to pay pensions related to salaries and years of service, have been losing ground to defined-contribution schemes, in which pensions depend on returns on money saved in employees' individual plans. A recent study by Watson Wyatt, a consultancy, found that the number of *Fortune* 1000 companies that had frozen or ended their DB plans, or had said they would, rose from 34 in 2001 to 113 last year. Stricter rules on pension

accounting and funding, says David Wyss of S&P, “will speed the decline of corporate pension plans.”

Companies say they dislike the volatility of pension-scheme valuations and the thought that they will become jumpier still. Some believe that companies are using recent pension reforms as an excuse to dump DB plans, when an easier way to deal with volatility would be to match schemes' bond-like liabilities with their assets, of which 60% are in shares, estimates UBS. “The real reason is that they just don't want the responsibility,” says a government official. Better matching would require companies to back their promises with more cash. Don't hold your breath.

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German banks

Welcome to the wild frontier

Jul 20th 2006 | FRANKFURT
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A dose of reality for investors of a German mortgage bank

KNOCKING the weakest bits of any financial system into shape is likely to cause some bruises. So creditors of AHBR, once Germany's biggest mortgage bank, are discovering. Last December AHBR, owned and driven almost to destruction by the trade unions, was bought by Lone Star, a Texan private-equity firm. In fact, "bought" may not be the word: the owners gave Lone Star €871m ($1.0 billion) to take the thing. Now Karsten von Köller, head of Lone Star's German business and new boss of AHBR, is aiming to shrink the €80 billion mortgage book to €10 billion, working out non-performing loans and fending off angry creditors.

Most strident of those are holders of "silent participations" and *Genussscheine* (participation certificates), both loan instruments that behave like equity, taking a hit if the issuer makes a loss. Mr von Köller surprised investors in January by announcing new-found losses at the bank of around €1.1 billion, which would knock 75% off the capital of those two instruments.

The investors were not amused. Holders of the silent participations, mostly banks, protested that Lone Star's €871m, which included a €500m fund built expressly to cushion losses, should take the first hit. Holders of the *Genussscheine*, most of whom think of their paper, mistakenly, as high-yielding debt rather than equity, protested that they had been misled about the true state of the bank. Last November it announced a small profit for the first nine months of 2005.

DZ Bank, the biggest holder of silent participations, has played a game of brinkmanship with Lone Star. It threatened to torpedo AHBR's sale of a €3.5 billion mortgage portfolio, an important part of AHBR's restructuring. That prospect worried not only Lone Star but also BaFin, Germany's financial regulator. One of BaFin's concerns is the health of Germany's €1 trillion *Pfandbrief* (mortgage-backed bond) market, which overreacted last October when AHBR came close to collapse.

On July 12th DZ Bank and DEVK, an insurer and another creditor, wrested concessions from Lone Star, reducing their losses by around €100m. That prompted lawyers acting for over 50 holders of *Genussscheine* to file a suit in a Frankfurt court. Among their gripes is that this concession has added to the overall burden for other loss-bearers.

AHBR's change of control, from sloppy trade-union stewardship to rougher Texan ways, has clearly come as a shock to some. Mr von Köller says that if investors sue anyone, it should be the banks that advised them. AHBR's problems, stemming from losses in interest-rate derivatives, have been known since 2001. The previous owners tended to shield other investors from those losses: now they are getting a dose of reality. But they would be facing a total loss, not just 75%, says Mr von Köller, had Lone Star not ridden in last year.

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Economics focus

The Cambrian age of economics

Jul 20th 2006
From The Economist print edition

Evolutionary economics is surviving, but not thriving

BEFORE he turned to the bigger fish that occupy the White House, Paul Krugman, an economist at Princeton University and a polemicist for the *New York Times*, enjoyed nothing more than frying the cranks, impostors and other forms of pondlife he found outside the mainstream of economics. In 1997 he singled out the purveyors of so-called "bionomics". Bionomics argued that economics was hopelessly wedded to the principles of mechanics, and should instead borrow ideas from evolutionary biology. After all, it declared, "a modern market economy is like a tropical rainforest".

Such heresy was not new. In the preface to his "Principles of Economics", Alfred Marshall, one of the founders of neoclassical economics, declared that "The Mecca of the economist lies in economic biology". But Mr Krugman showed little mercy. Arguing that his victims knew little about either economics or evolution, he dismissed their work as "biobabble".

Undeterred, Eric Beinhocker, of the McKinsey Global Institute, has undertaken his own 500-page *haj*, entitled "The Origin of Wealth: Evolution, Complexity, and the Radical Remaking of Economics". In places (such as its headline call for a "paradigm shift" in economics) the book may irk Mr Krugman and other gatekeepers of the profession. But it is good enough, and scholarly enough, to warrant their attention rather than their scorn.

Indeed, Mr Beinhocker is himself critical of "loose analogising" between biology and economics. The economy, Mr Beinhocker says, is not "like" a rainforest. Rather, economies and ecosystems are both evolutionary systems in their own right. The evolutionary formula—variation, selection and replication—is a formal, "all-purpose" principle, which can perform its magic equally well in either domain.

How, then, does the principle go to work on the stuff of economics? The business plan is the economic equivalent of DNA, and the enterprise its host in the world. Mr Beinhocker envisages a Borgesian library of every conceivable plan, from farming wheat in Lebanon in 8500BC to manufacturing "supernano neural-blastule tubes" that have yet to be invented. Evolution provides a remarkably effective way for the economy as a whole to scour this vast library for viable strategies, finding "needles of good design in haystacks of possibility," as Daniel Dennett, a philosopher, has put it.

Countless firms, busily tinkering with their business models, provide a source of variation. The market itself—what gets bought and what gets left on the shelf—imposes a powerful form of selection. And although business plans cannot reproduce, successful ones do command a growing share of the economy's resources, as companies expand on the back of them and rivals copy them.

Such a process succeeds at the level of the economy as a whole, while remaining coldly indifferent to the fate of individual firms within it. Indeed, Mr Beinhocker cites research showing that progress owes more to new firms replacing old than to incumbent firms renewing themselves. This is not a comfortable conclusion for businessmen who might buy this book. But as a McKinsey man, Mr Beinhocker cannot resist offering a few tips to executives who are not content to be "experimental grist for the evolutionary mill".

Such ideas are less threatening to economists: Milton Friedman evoked the notion of market selection over 50 years ago. But more unsettling than the ideas are the techniques and tools Mr Beinhocker advocates. He argues that economists should abandon blackboard deduction in favour of computer simulation. The economists he likes do not "solve" models of the economy—deducing the prices and quantities that will prevail in equilibrium—rather they grow them "in silico", as he puts it.

An early example is the sugarscape simulation done in 1995 by Joshua Epstein and Robert Axtell, of the Brookings Institution. On a computer-generated landscape, studded with “sugar” mountains, they scattered a variety of simple, sugar-eating creatures, which compete for this precious commodity. Some creatures move faster than others, some see farther, and some burn sugar at a higher metabolic rate than their rivals.

The pandas of economics

Surprisingly, the results of their myopic lives can be gripping. Even simple rules of behaviour result in collective patterns that are impossible to foresee yet easy to recognise. The sugarscape, for example, is quickly beset by a division between haves and have-nots, which bears a strong statistical resemblance to the distribution of income in real economies. These macro-results cannot be deduced from the micro-rules simulators write. Rather, they emerge from the interactions of the creatures in the model, just as “wetness” emerges from the interaction of water molecules, rather than being a property of the molecule itself.

Such simulations may be unpredictable, but they are nonetheless understandable, Mr Beinhocker insists. By toying with different parameters, such as metabolic rates or the height of the sugar mountains, analysts can learn how to “tune” their model to generate different results. This understanding may be more valuable than a forecast, he argues. But whatever such enlightenment is worth, it is not easy to communicate to others. The revelations contained in a deductive proof or theorem are easy to pass on: they leave a set of footprints for other people to follow, making it easy for a theory to persuade and convert. For simulations, by contrast, “the only way to see what happens is to run the model and evolve it—there is no shortcut.”

For the moment, then, evolutionary economics remains a niche pursuit, not the intellectual revolution Mr Beinhocker predicts and hopes for. It is ironic that evolutionists, of all people, should have such trouble reproducing themselves.

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About sponsorship

Phantom limbs and chronic pain

A hall of mirrors

Jul 20th 2006
From The Economist print edition

The search for a new way to treat chronic pain

PEOPLE who have had parts of their bodies amputated often experience a vivid and bizarre sensation that their missing limbs are still there and can even be moved around. Most also suffer an excruciating pain in these sensory ghosts, which are known as phantom limbs. It is difficult enough to alleviate pain that has known causes, such as that triggered by inflammation and cancer. Treating pain in a limb that does not exist is harder still.

There is, though, a technique that works. It uses mirrors to create an illusion that the missing limb is still there. What nobody has known until now is how this helps. But Herta Flor of the University of Heidelberg in Germany, thinks she might have cracked it. If she is right, as she explained to an audience at the recent Forum of European Neuroscience in Vienna, she may have opened a door to the treatment of other forms of persistent pain.

All in the mind

Dr Flor and her colleagues studied people who suffer from a form of phantom limb known as a telescoping phantom. After the amputation of a hand at the wrist, some patients feel the missing hand extending from the amputation stump (an extended phantom), whereas others feel it coming out of the elbow (a halfway retracted phantom) or the shoulder (a completely retracted phantom). The researchers wanted to know what causes these illusions, so they asked their patients to imagine that they were opening and closing their missing fists, and measured their brain activity during this process using magnetic-resonance imaging (MRI).

Patients with extended phantoms showed activity in the hand area of a part of the brain called the motor cortex, which is responsible for controlling movement. This response is identical to that shown by unamputated volunteers asked to do the same thing.

Those with halfway retracted and completely retracted phantoms had different responses. They showed activity in the elbow and shoulder areas of the motor cortex respectively. In other words, a greater degree of retraction involves a greater rewiring of the brain. And the greater the retraction, the worse

the pain.

That correlation led Dr Flor to wonder if the alleviation of pain caused by the mirror treatment might be the result of a reversal of the neurological changes associated with telescoping. In the mirror treatment, a patient with an amputated hand places his normal and phantom hands on each side of the mirror. The position of his normal hand is adjusted so that its reflection in the mirror is superimposed on the position he feels his phantom hand to be in. He is then asked to move his hands (both normal and phantom) simultaneously, and to watch them moving. The illusion created by the mirror gives him the impression that both of his hands are, indeed, moving. After a few weeks of such daily treatment sessions, each lasting 15 minutes, about half of patients report that their phantom limbs and the pain associated with them have disappeared.

To understand what is happening, Dr Flor and her colleagues resorted once again to MRI, to record the brain activity of amputees while they were performing the mirror task. As predicted, patients without phantom-limb pain showed activity in the hand area of the motor cortex. They also showed activity in the hand area of the sensory cortex, the part of the brain that receives signals from the hand. The mirror was giving visual feedback that the sensory cortex was interpreting as a real hand.

Those with pain lacked this visual feedback system, and showed no activity in the sensory or motor cortex. Dr Flor conjectures that the mirror therapy might be able to restore the feedback mechanism in patients with retracted phantoms by providing enough nerve input for the brain to reverse some of the changes that follow amputation. The team is now conducting follow-up experiments to see whether this is what is happening.

All of these results suggest to Dr Flor that phantom-limb pain is best understood as a form of unconscious learning, similar to motor reflexes and perception skills. According to this interpretation, mirror therapy works by replacing noxious memories with innocuous ones.

With this hypothesis in mind, she reckoned that another way to treat phantom-limb pain might be to prevent pain memories from forming in the first place. To test this idea, she asked a number of patients undergoing amputation to take a drug called memantine. This blocks the activity of protein molecules called NMDA receptors, which are important in many types of learning and memory.

Thirteen patients took memantine for four weeks after their amputations (and sometimes just before, as well). The researchers then studied those patients' brain activity and bodily sensations over the course of a year, comparing what they found with the results from a group of amputees treated with a placebo.

To their delight, they discovered that memantine not only reduced changes in the brain, it also decreased both the incidence and the intensity of phantom pain. Pushing a bit further, Dr Flor wondered whether her pain-memory theory applied to other types of chronic pain, as well. She turned to a phenomenon called fibromyalgia, which is characterised by widespread pain across the body. Using MRI, her team detected a network of abnormal memory traces in the brains of people with this condition. Many parts of their brains are hyperactive, not only in areas responsible for bodily sensation and movement but also in those involved in the sensation and processing of pain. The researchers also found that memantine was able to dampen brain activity in some affected areas and reduce pain accordingly.

Encouraged by this result, they are now attempting to remove pain memories using drugs that activate the brain's system of cannabinoid receptors. Previous studies have shown that these receptors are involved in extinguishing unpleasant memories such as those related to fear. Dr Flor's hope is that pain—being, in her view, a form of unpleasant memory—will be similarly susceptible.

She is also trying approaches that do not involve drugs. The team has, for example, used cognitive behavioural therapy to train patients with fibromyalgia not to react to pain but rather to focus on enjoyable activities. Dr Flor believes that, by removing the reinforcement loop and bringing in so-called pain-incompatible memories, traces of pain in the brain can be reduced or even extinguished.

If Dr Flor's memory hypothesis is correct, revolutionary approaches for treating chronic pain may be on the horizon. This will be wonderful news for millions of people suffering from this condition. After all, pain is all in the mind. Indeed, pain itself is an illusion, a phantom in the brain. The brain, therefore, may be a good place to start chasing away this ghostly and debilitating sensation.

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Imaging techniques

Reading the invisible

Jul 20th 2006
From The Economist print edition

The last few pages of an ancient Greek manuscript are about to be unveiled

ARCHIMEDES of Syracuse is hailed by some as the greatest mathematician of antiquity. Ignoring a clunky numerical system and devising his own, he demonstrated the nature of infinity and calculated a value for pi. He realised that the volume of an object can be measured by how much water it displaces, a discovery he is said to have made in the bath and which caused him to run naked through the streets of the city shouting “eureka” (“I have found it”). Now, a new use for an old particle accelerator is poised to reveal more of his thoughts.

Starting on July 26th, researchers at the Stanford Synchrotron Radiation Laboratory in California, led by Uwe Bergmann, will attempt to read the final pages of the oldest known manuscript of Archimedes's work, the Archimedes palimpsest.

Archimedes lived in the third century BC but, in the tenth century AD, a scribe copied out his works. Two hundred years later, the book of 90 pages was unbound and washed so that the goatskin parchment could be reused, producing what is known as a palimpsest, in which the older writing is sometimes visible under the new. The leaves were folded in half to produce a volume of 174 pages, and Christian prayers were inscribed in it. Forgers who added gold religious images sometime after 1930 further damaged the document.

Much of the text has already been read, but between 10% and 20% remains hidden, particularly under the forged images. In places, the ink from the original text is no more than a faint stain, so the scientists studying it need a technique that is sensitive to very low concentrations of ink.

The answer, they hope, will be X-ray fluorescence imaging. The ink contains iron, and traces of iron can be made to reveal themselves when bombarded with X-rays. Iron atoms have 26 electrons in different orbitals around their nuclei. An X-ray tuned to the correct energy can knock an electron out of the innermost orbital. This makes the system of orbitals unstable and an electron from an orbital further out rapidly fills the hole. As this replacement electron falls into place, it emits an X-ray at a second specific energy. A detector captures each X-ray having this energy, building up an image of the ink dot by dot.

In principle, this could be done using any suitable X-ray source, but the Stanford synchrotron is so powerful that it can reveal in a day what might take others months. That power, though, comes at a price. To ensure the beam does not loiter on the parchment and damage it, the researchers have had to design the procedure so that the X-ray beam cannot be on when the manuscript is stationary.

To help read the pages damaged by forgers, the researchers also plan to fire X-rays into the backs of the parchment leaves and measure fluorescence from elements other than iron—including zinc and barium—that are found in the paint but not in the ink. They hope this will help to determine if a mark is just paint or whether there may be text underneath.

A two-week test run has proved successful. The first page of the manuscript, which had previously proved illegible, revealed some of its secrets. The X-ray imaging showed its contents, including the name of the scribe who overwrote the parchment with religious text. He was called John (his surname is still being deciphered), he was a priest and he finished his labours on April 14th 1229.

Indeed, the test was so successful that Dr Bergmann hopes to obtain images that will reveal missing text from “The Method of Mechanical Theorems”, the only copy of which is contained in the palimpsest. Such an achievement would allow scholars to cry out their own “eureka!”

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Spacesuits

Your inflexible friend

Jul 20th 2006
From The Economist print edition

Sometimes the old ways are the best

IF YOU want to conserve energy, walking rather than running is the best plan. At least, on Earth it is. However, Christopher Carr, a researcher at the Massachusetts Institute of Technology, has shown in his recent research that for astronauts exploring places with lower gravity than Earth, the reverse is true. If they run, rather than walk, they can achieve more in the limited time before their oxygen runs out. They can also travel further from their spacecraft because, in an emergency, they can get back faster. This discovery calls into question efforts to design new spacesuits for America's much-vaunted plan to send people back to the moon, and eventually to Mars.

The instinct of engineers at NASA, America's space agency, is to improve on the suits used three and a half decades ago during the Apollo project by making them less rigid. That would make them easier to walk in. But pulling this redesign off is tricky, because their rigidity is a result of their internal pressurisation. In inflatable spacecraft (see article) rigidity is a good thing. In spacesuits, it has been thought of as bad.

NASA

Er, which way now?

Dr Carr, however, has been reviewing the performance of the Apollo suits by looking at footage shot on the moon and by studying the astronauts' own thoughts. He thinks the basic design of the suits—inflexibility and all—is far sounder than any of the proposed improvements.

After immersing himself in the lunar-landing films and journals, he noticed that although the inflexibility of the suits did indeed create difficulties for astronauts when they bent down to collect rock samples, they found the action of running in a suit on the moon as easy as running on Earth without one. Nor was this a mere personal perception. By matching recordings of astronauts' oxygen consumption with what the films showed they were doing at the time, Dr Carr was able to show that their rate of oxygen use was indeed lower during running than walking.

To explain this counter-intuitive finding, Dr Carr looked at the energy expenditures behind running and walking on Earth and on the moon. The argument hangs around what is known as a Froude number. This number is calculated by squaring a person's walking (or running) speed, and dividing the result by his leg length and (crucially) the strength of the local gravitational field.

If the Froude number exceeds 0.5, then it is more efficient to run than to walk. On the moon and Mars, where gravity is weaker than on Earth, that is generally the case. And, since the stiffness of the suit seems no impediment to running, there seems no need to engineer it out. Indeed, it may actually help.

Using a low-gravity simulator (actually, a giant elasticated harness), Dr Carr found that the rigidity of spacesuits means that they act as springs—assisting the act of running. The upshot is that, even in space travel, old designs are sometimes better than new ones. Perhaps, instead of planting flags when they go to the moon and the planets, astronauts of the future should stick signs in the ground that say “Run, don't walk”.

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Space travel

From Russia, with love

Jul 20th 2006
From The Economist print edition

A private space "building" is launched

IT IS like a storyline from a James Bond film. On July 12th a reclusive billionaire launched an inflatable spacecraft into orbit. The craft, called *Genesis I*, blasted off from a military base in Yasniy, Russia, on a converted intercontinental ballistic missile. The mission was, however, conceived and paid for by an American, Robert Bigelow, a tycoon who made his money in the hotel business.

Disappointingly, Mr Bigelow's headquarters is not under an extinct volcano. But it is in Las Vegas, which seems an acceptable substitute, and the mission's control room, with its array of sleek desks and giant wall of colourful display panels could easily double as a Hollywood film set. Mr Bigelow's motives, though, are entirely proper—if appropriately ambitious. He plans to spend half a billion dollars between now and 2015 developing what he calls "flexible space-complex architecture". As a logical extension of his earthly business, he wants to create real estate in space.

Bigelow Aerospace, as the firm running the mission is known, licensed the technology used to build *Genesis I* from NASA, America's space agency, in 2001. The craft is made of several layers of vectran, a strong artificial fibre, and has foam shielding to protect it against micrometeorite impacts. Future versions will use water blankets for radiation shielding. The mission is intended to last five years and is designed to determine the craft's resistance to the various hazards of being in space.

Inflatable spacecraft are attractive because they take up far less room on a launch vehicle than rigid craft of the same ultimate dimensions, and are thus cheaper to put into orbit. At 4.5 metres (15ft) long, with a diameter of 2.4 metres, *Genesis I* is a one-third scale model of the craft that is Mr Bigelow's ultimate ambition. It is the first of between six and ten test modules that he hopes to launch over the next decade.

Mr Bigelow's ultimate vision is to bring the terrestrial principles of real-estate development and finance into space, in order to spread the benefits of space travel to the common man and woman. On his website he points out that, on Earth, developers build everything from shopping centres to office buildings and to do so have to command a range of skills that include design, construction, finance and logistics. He sees no reason why space should be different. Once his test flights are over, he hopes to offer space habitats for sale and for lease.

Who will be interested in buying is not yet clear, but Mr Bigelow is betting there will be a market for such things as inflatable space hotels and orbital research laboratories. Build it, as the saying goes, and they will come. At least, he hopes they will.

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Correction: scientific publishing

Jul 20th 2006
From The Economist print edition

In "Creative destruction in the library" (July 1st) we said that there was a proposal before Congress to make the results of federally funded research available free as soon as they are published. This was wrong. The proposal is to make them available free after six months.

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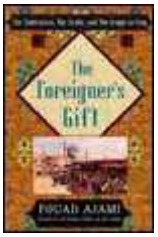
Arabs and democracy

Not yet, say the Arabs

Jul 20th 2006
From The Economist print edition

Why democracy will not sink roots in the Arab world, at least in a hurry

The Foreigner's Gift: The Americans, the Arabs, and the Iraqis in Iraq
By Fouad Ajami



Free Press; 400 pages; $26

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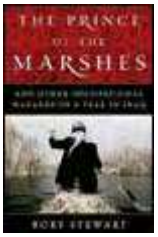
The Prince of the Marshes: And Other Occupational Hazards of a Year in Iraq
By Rory Stewart



Harcourt; 416 pages; $25. Published in Britain as "Occupational Hazards"; £17.99

Buy it at
Amazon.com
Amazon.co.uk

Arabs
By Mark Allen

Continuum; 145 pages; $21.95 and £14.99

Buy it at
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Amazon.co.uk

FOR those who think that an onrush of democracy is the answer to the Arab world's malaise, these books are disheartening. This is so, even though one of their authors, Fouad Ajami, hails from a rare breed: an Arab (now an American citizen) of Lebanese Shia background who enthusiastically backed George Bush's plan to spread democracy throughout the Middle East, starting most hazardously in Iraq.

None of these books asserts categorically that the Arabs are unfit for, or incapable of, democracy, but all make plain how extraordinarily hard it will be for a system of one-person-one-vote to sink roots in such unfamiliar soil. Not a single country in the 22-member Arab League is a stable, full-fledged democracy: the three that currently come closest—Lebanon, the Palestinian territories and Iraq—are all peculiar and flawed cases, and are now all in particular trouble.

Indeed, the title of Mr Ajami's book has, perhaps unintentionally, a mocking ring to it. The “gift” of which he speaks is presumably the enforced imposition by the United States of a new and, with luck, democratic rule which the Arabs—Mr Ajami ruefully admits—are unlikely to embrace with ease, let alone with gratitude.

His book is the most awkwardly problematic of the three because its message betrays fiercely conflicting feelings. A professor of Middle East studies at the Johns Hopkins School of Advanced International Studies in Washington, DC, Mr Ajami has been a courageously outspoken proponent of the neo-conservative cause. The war in Iraq, he insists, is “a noble war”, which will end in “noble success or noble failure”. In a sometimes bitter, occasionally trenchant but ultimately confusing polemic he castigates most of his fellow Arab intellectuals and most Arab leaders for their failure to support or applaud the war.

He hails the opportunity that America's intervention has afforded in the region as a whole. There was “the promise of a new beginning—a base of American influence free of the toxic anti-Americanism at play in both Saudi Arabia and Egypt.” With rather contrived optimism, he describes conversations during his six visits to Iraq since the invasion with Shia, Sunni and Kurdish notables. He also expresses unabashed admiration for Ahmad Chalabi, the neo-cons' long-time favourite to lead the new Iraq, and bemoans his fall, without explaining why it happened.

The dominant tone of Mr Ajami's treatise is one of lamentation. Despite the supposed attractions of the new deal the Americans have offered Iraqis, the beneficiaries have been patently unable, for a host of reasons, to grasp it. “The steady refusal of the Shia to come out openly in support of the American project had been one of the great surprises of this expedition.” It may have surprised Mr Ajami; it did not surprise others familiar with Iraq's exceptionally violent and fractious history for the past half century and more.

Mr Ajami has a sadly nostalgic section on the fine poets and liberal intellectuals who prospered in Baghdad in the first half of the 20th century. Will their moment come again under the new imperium? There is no sign that it will. The book gives way to a forlorn litany of the tragic events and missteps since Saddam Hussein's fall. “Nothing here is what it seems,” says one of the secular-minded politicians whom Mr Ajami admires. “If you see an elephant, it's probably an ostrich.”

Rory Stewart's tale is told very differently. A former British diplomat who had previously tramped on foot across Afghanistan, he found himself, for most of the year after the invasion, in charge of Maysan, an Iraqi province bordering Iran in the south-east. It is a story of appalling chaos, local Iraqi chicanery and violence, and administrative mayhem imposed from outside (mainly by Americans), told with candour, humour and insight.

Compared with the mainly Sunni Arab provinces north and west of Baghdad, Mr Stewart's mainly Shia area in Maysan was mild. But he makes it plain, without wringing his hands or denigrating the locals, that the culture of violence along with tribal and religious intrigue make it unthinkable for Western democratic values to take root any time soon. He sought to appoint provincial councils, governors and police chiefs, but most of his constituents had no concept of democratic procedure. “If they make any trouble,” explained one leading politician of a rival group, “we together will kill them.” “If you put my cousin on the [provincial] council,” explained another local bigwig, “I will slit his throat.” “Seyyid Rory, you don't understand,” complained another. “How do you make a prisoner talk if you don't torture him?” Though in no way flippant or sneering, Mr Stewart makes it plain that the neo-conservative agenda in such areas is absurd.

Messrs Stewart and Ajami make glum reading. By contrast, a slim volume by one of Britain's leading diplomatic Arabists, Mark Allen, is an amiable and in many ways more useful guide. Knighted for—among other things—his apparently key part in persuading Libya's Muammar Qaddafi to give up his programme to build nuclear weapons, Sir Mark, a long-serving member of MI6, Britain's external intelligence service, offers a thoughtful potpourri of observations on the Arab psyche and identity. Acknowledging that “a systematic technique for dealing with contradictions and dissent” is woefully lacking in the Arab world, he also stresses that the old-fashioned bonds of blood, tribe, religion and pan-Arab identity tend to govern behaviour and can, if subtly addressed, be woven to good effect. Politics is still necessarily personal and clan-based; antipathy to *fitnah* (social discord and strife) makes it hard to envisage a peaceful institutionalisation of adversarial politics. These and other caveats, born of nearly four decades in the Middle East, offer more useful hints than the laments of a disappointed Arab-American neo-con.

The Foreigner's Gift: The Americans, the Arabs, and the Iraqis in Iraq.
By Fouad Ajami.
Free Press; 400 pages; $26

The Prince of the Marshes: And Other Occupational Hazards of a Year in Iraq.
By Rory Stewart.
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Asia's overland route

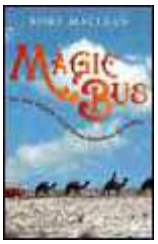
Hit the road, Jack

Jul 20th 2006
From The Economist print edition

IN THE 1960s, thousands of free-spirits set forth on the world's wildest trail, stretching 6,000 miles across six countries and three religions. The Asian odyssey began in Turkey and, barring mechanical (or mental) breakdown, took in Iran, Afghanistan and Pakistan before ending up in the revered destinations of India and Nepal.

Rory MacLean retraces the steps of these “intrepids” to find out why the hippie trail became the journey of the age. The original flower children, he explains, wanted to swap the conformism of the 1950s for spiritual enlightenment. Inspired by the music of the Beatles and Bob Dylan, the works of Jack Kerouac and Allen Ginsberg, and the social revolutions of the time, they flocked east aboard a patchouli-scented convoy of psychedelic buses, Bedford trucks and VW campervans.

Magic Bus: On the Hippie Trail from Istanbul to India
By Rory MacLean



Viking; 292 pages; £16.99

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Amazon.co.uk

Thousands took to the road, fuelled by dope and the dream of nirvana. In 1968, the year the Beatles were meditating with the Maharishi in Rishikesh, there were 10,000 young foreigners in India. Five years later, that number were crossing the border from Pakistan each week. By the mid-1970s, Afghanistan, an easygoing paradise, welcomed 90,000 visitors a year.

Mr MacLean is an entertaining guide, conjuring the flavour of the trail: the Pudding Shop in Istanbul catering for the travellers' “sugar-craving munchies”; the rose-scented, bug-infested Crown hotel in Delhi; pipes of Mustang at the Eden Hash Centre in Kathmandu; embroidered jeans, ankle bells, karma, peace and love.

Yet “Magic Bus” is more than a series of travel anecdotes; it raises questions about how the hippies influenced the places they visited. In Turkey, the author learns how their rejection of materialism spurred their host's material prosperity. In Iran, he asks if their “casual morality” stirred the “stern Islamic reawakening”.

The popularity of the overland route declined when Iran's borders closed in 1979. Yet the trail gave birth to an industry which has packaged the globe. Independent travel is fashionable, students' gap years are becoming the norm, and guide books—the route was the starting point for the Lonely Planet empire—sell in huge numbers. Sadly, however, politics has, in one way or another, put the brakes on the magic bus.

Magic Bus: On the Hippie Trail from Istanbul to India.
By Rory MacLean.
Viking; 292 pages; £16.99

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American law and politics

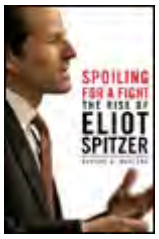
Hero or bully?

Jul 20th 2006
From The Economist print edition

WHEN lawyers speak, laymen are often baffled. So it is refreshing to hear an exchange such as the following, between the attorneys-general of New York and California, as reported in the *American Lawyer*. “You want to step outside, that's fine! I grew up in the Bronx!” said Eliot Spitzer, New York's attorney-general. “No problem,” shouted Bill Lockyer, California's attorney-general, “I grew up in east LA. Let's go!” In the end, the two men settled their dispute without violence.

What does this incident tell us about Mr Spitzer, who is likely to be elected governor of New York state this year? As the title of Brooke Masters's new biography suggests, Mr Spitzer is a combative fellow. He can be admirably plain-spoken, too. But his aggression is not always channelled to useful ends, and he sometimes talks up a tempest but fails to follow through.

Spoiling for a Fight: The Rise of Eliot Spitzer
By Brooke A. Masters



Henry Holt; 368 pages; $26

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To his boosters, Mr Spitzer is a paragon among prosecutors: diligent, imaginative and incorruptible. He gets up at five and, after a run and shower, works tirelessly to bring mighty malefactors to justice. He cut his teeth breaking up a mob-connected trucking cartel. On becoming New York's top prosecutor in 1998, he went after bigger targets. In 2002, for example, he wrung a $1.4 billion settlement out of ten investment banks for hyping dud stocks to small investors, among other transgressions. His record of fighting for the little guy makes him an ideal Democratic candidate.

To his detractors, Mr Spitzer is a bully who abuses his office to further his political career. Bashing Wall Street generates vote-wooing headlines. But his critics charge that he sometimes disregards due process. He makes accusations amid media fanfare and then quietly drops them when he cannot find evidence that would stand up in court. By threatening to indict whole companies—spelling certain bankruptcy—he forces their managers to settle. Ms Masters, a *Washington Post* reporter, is studiously even-handed in telling the story, but it is clear where her sympathies lie. Her first chapter is entitled: “When markets need to be tamed”.

Her book is thorough and often engaging. We learn that Mr Spitzer came from a competitive family where Scrabble routinely sparked friendly but intense squabbles. His father, a squillionaire property developer, once reduced young Eliot to tears during a game of Monopoly. “He said, you're going to learn what happens when you borrow and you don't repay,” Mr Spitzer recalled.

Mr Spitzer's combativeness, says Ms Masters, has led some observers to wonder whether he has “the temperament to serve effectively as governor, a multifaceted executive job that require[s] both administrative and conciliation skills.” Or, as the *Wall Street Journal* more pithily put it, New Yorkers should question “whether Mr Spitzer's habit of publicly smearing individuals while bringing no charges in court is appropriate behaviour by any prosecutor, much less one running to be New York's governor.”

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By Brooke A. Masters.
Henry Holt; 368 pages; $26

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English civil war

Heads you win

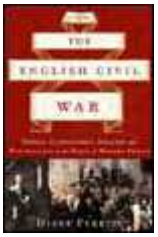
Jul 20th 2006
From The Economist print edition

FROM his vantage point on the scaffold, Charles I would have had a good view of the spot where policemen now guard the entrance to Downing Street, Tony Blair's residence and office. The falling axe brought about a decisive shift of power from the world of the court to that of Parliament. But it was not as straightforward as that. Rather than severing the idea of a hereditary head of state permanently, Charles's shabby trial and violent death helped the monarchy to survive for far longer than it otherwise would have.

Diane Purkiss's book about the English civil war runs through the story of the conflict between king and Parliament. But what really interests her is what the civil war might have felt like to those caught up in it. To get at this she uses news-sheets, cookery books, diaries and autobiographies, particularly those of women. The result is a book that is as enjoyable as histories of this episode often promise to be, but somehow seldom are.

Early on we are introduced to two women, Lucy Hay and Anna Trapnel. Hay inhabited the West End of London and the court; Trapnel was an Eastender, familiar with the world of the docks and the poor. By the time the first shot is fired, they have both ended up on the parliamentary side, though for very different reasons. Hay, according to Ms Purkiss, was responsible for warning five members of Parliament of their impending arrest. Trapnel became a religious zealot, fasting to the point where visions of Daniel appeared to her as frequently as other people drank cups of a fashionable new drink called coffee.

The English Civil War: Papists, Gentlewomen, Soldiers, and Witchfinders in the Birth of Modern Britain
By Diane Purkiss



Perseus; 627 pages; $35. HarperCollins; £25

Buy it at
Amazon.com
Amazon.co.uk

The civil war forced these two, as so many others, to choose between the royalist and the parliamentary cause. Some followed traditional allegiances, others religious impulses, others personal advantage. Very few thought they were fighting for the republic that, briefly, they ended up with. Both factions claimed to be for the true religion (reformed Protestantism) and against tyranny. The news-sheets published by either side made remarkably similar accusations against the enemy.

Just as there was no clear ideological divide, there was no Mason-Dixon line that separated England into camps. Instead, lines were drawn within towns and within families. John Milton, for instance, who had a career as a republican pamphleteer before settling down to be the era's greatest poet, married into a family of staunch royalists, who no doubt loathed their son-in-law's opinions. The marriage turned sour, and Milton turned his hand to radical pamphlets in favour of divorce.

Religious attitudes were a rough predictor of which side someone would take. Anyone who, like Milton, had visited Calvin's training camps in Geneva would identify with the godly party in Parliament. So might those who suspected the queen (who had refused to attend Charles's coronation because the service was Protestant) of using her husband to bring Catholicism to Britain. But though anti-Catholicism was widespread (and disproportionate: there were only 30,000 Catholics in the country), fear of the evangelical crazies in Parliament's army became a powerful recruiter for royalism.

So, eventually, did the king's death. For most of Charles's life people had covered for him. In 1610, his part in a court masque had to be contrived to hide his weak legs; a circle of children surrounded him while he danced. His beheading was different. It brought a sigh from the crowd and a rush to dip handkerchiefs in the royal blood, for use against scrofula. And it helped to preserve the monarchy into its present age of unassailable irrelevance—a 350-year apology from loyal subjects for having once been so beastly.

The English Civil War: Papists, Gentlewomen, Soldiers, and Witchfinders in the Birth of Modern Britain. By Diane Purkiss.
Perseus; 627 pages; $35.
HarperCollins; £25

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New cinema

Story's story

Jul 20th 2006 | LOS ANGELES
From The Economist print edition

Fantasy with a moral

AFTER his four successful, rather spooky films for the Walt Disney Company, any new film by the young Hollywood writer and director M. Night Shyamalan (pronounced SHA-ma-lon) is sure to be an event. Adding controversy to the event, “Lady in the Water” comes accompanied by an unusually revealing book about its making: “The Man Who Heard Voices”, by Michael Bamberger (Gotham Books).

No student of film, Mr Bamberger, a senior writer at *Sports Illustrated*, approaches his subject as he might Tiger Woods or Michael Jordan (who happen to be two of Mr Shyamalan's heroes) at some turning point in their careers. His book tells in detail why Mr Shyamalan dumped the Walt Disney Company, his home for six years, to make this film for Warner Bros. There is irony here: “Lady in the Water” would seem, at least at first glance, to be the most Disneyesque film he has ever made.

Sea nymph and superintendent

Paul Giamatti plays Cleveland Heep, a superintendent of a modest Philadelphia apartment building who finds a sea nymph, played by Bryce Dallas Howard, in the building's swimming pool. The nymph, whose name is Story, comes from the Blue World, an undersea kingdom whose inhabitants were once in regular communication with the human race. The breaking of that ancient link has made mankind warlike, and Story has been sent to our world to save it.

Is this “E.T.” meets “The Little Mermaid”? Only on paper. To begin with, the star of the film is not Ms Howard, a pretty tomboy, made up to look slightly cadaverous, who is initially taciturn, then unconscious after being attacked by a grass-covered wolf intent on making mincemeat of her before she carries out her mission.

Instead, we are drawn first to Mr Heep and then to the multicultural inhabitants of the apartment building. They are the film's raison d'être; she is simply its narrative catalyst—a catalyst appropriately named Story, because the myth she comes from has been kept alive as a children's story that Mr Heep hears in dribs and drabs from a Korean tenant.

Gradually the story expands to take in all the inhabitants of the building, each of whom is there for a reason: a self-doubting writer played by the film-maker, a fitness buff (Freddy Rodriguez) who only works out with one side of his body, a dour film critic (Bob Balaban) who can predict where the story is going because there are no new plot twists under the sun, a woman (Mary Beth Hurt) who attracts butterflies, another (Tovah Feldshuh) who reveals the embarrassing secrets of her unseen husband, a crossword puzzle addict (Jeffrey Wright), five nicotine addicts and a Hispanic paterfamilias with five shrieking daughters. It is Mr Heep's task—and theirs—to figure out the role each plays in Story's story to get her home in one piece.

Political observers are fond of talking about the need for a new national “narrative”. Mr Shyamalan seems to be offering something like the narrative of that narrative—a myth about a myth that brings disparate tenants together and shows each of them who he or she really is. The result is a messy masterpiece, a portrait of turbulent transition, that constantly risks falling on its face but almost never does.

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About sponsorship

American art

A prophet in his own country

Jul 20th 2006 | SOUTHAMPTON, NEW YORK
From The Economist print edition

Honoured more in Europe than in America, Robert Wilson explains why he still chooses to stay in America

ROBERT WILSON, a theatre and opera director aged 64, is one of the abiding paradoxes of American art. He has created works that have entranced and infuriated critics and audiences in equal measure. Renowned for his epic scale and fanatical attention to detail, he has been loved by audiences in continental Europe and regularly wooed by famous houses in Hamburg, Berlin and Paris. But for the past two decades he has been virtually ignored in his native America.

He is, above all, a designer, a maker of unique stage visions. He works in startling, some say cold, static imagery. His characters are tightly choreographed and without passion. Though not inimical to words, he is happiest when using a stage like a painter uses bare canvas. His 1971 work, “Deafman Glance”, was a literally silent opera, running for four hours.

But when Mr Wilson has worked in America, he has not had an easy time of it. His 1976 opera, “Einstein on the Beach”, with a score by Philip Glass, remains his most famous staging. It was a hit in Europe, greeted with the kind of clamour usually reserved for rock bands. When it arrived in America, after travelling through much of Europe, the opera was a critical success but was mounted just twice, at the Metropolitan Opera in New York, and left both Mr Wilson and Mr Glass with huge debts.

Then, in 1984, a project by him called “the CIVIL warS” was scheduled to open the Los Angeles Olympics. Because of financing problems, and no doubt its length—12 hours in its entirety—the show was cancelled by the Olympic Arts Committee at the last minute. It bankrupted Mr Wilson for years.

Despite these past misadventures, it is in America that Mr Wilson has chosen to develop his most ambitious project to date. This is the Watermill Centre, an arts centre for conferences, student bursaries, workshops and intercultural exchange, with no precise parallel in either the United States or Europe.

Situated in six acres of lush woodland near Southampton, at the eastern end of Long Island, Watermill is a former electronics laboratory, abandoned by Western Union in 1959 and a ruin when Mr Wilson earmarked the site in the late 1980s. After 14 years of renovation and close on $12m, the centre officially opened on July 15th with a gala benefit that included a lavish dinner for 400 and Mr Wilson quoting Martin Luther King's “I have a dream”.

As is normal for arts projects in the United States, the Watermill Centre receives no public subsidy and relies on private sponsors (though they, in turn, are subsidised by tax-breaks). Mr Wilson's financial struggles over the centre have been as dramatic as any show he could invent; the proceeds of everything he does, including the plays and operas he directs in Europe, go towards supporting it.

He claims that if he had decided to set up the centre in, say, Germany, “Public money would be available and I and the centre would be seen as an asset to public cultural life. Here, it is all about fund-raising, private capital and not-for-profit organisations. When I first began thinking about renovating the lab, I asked a friend how best to do it. She said, ‘Hold a riotous benefit and make sure it burns down.’ She was right: a fire would have saved me very, very large sums of money.”

Why, given all this, your correspondent asked him, does he choose to stay in the United States?

“The US is my home,” he answered. “Also, I think it vital in these times, when America is perceived, rightly or wrongly, as a closed, frightened society, to keep an open door. I don't subscribe to a ‘school’ or

to a single way of doing things. If I can get students and arts practitioners from Cuba and Indonesia to come and work here, then the Watermill will have more than half-achieved what it set out to do."

It is a handsome building. Sixteen people can live there and it houses Mr Wilson's vast collection of *objets*—chairs, sculptures, figurines, photographs—and his archive. It is reached by steps climbing steeply through grass and bushes. On either side, two wings are encased in light-grey corrugated iron, with the corrugations running horizontally. The building catches the idea of a laboratory, in the widest sense of the word: a happy meeting of sleek aesthetics and science.

Some observers detect a trace of egomania in the whole project, murmuring about Richard Wagner's Bayreuth. Mr Wilson does not duck the charge. "The Watermill is a place I want left standing long after I am gone... It should be a record of the art of our time, the art of our nation, America, for sure, but also the art of all nations."

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About sponsorship

Syd Barrett

Jul 20th 2006
From The Economist print edition

Roger “Syd” Barrett, leader of Pink Floyd, died on July 7th, aged 60

Mick Rock www.mickrock.com

TO THOSE who were young then, the late 1960s were the best thing since 1789. All that followed paled by comparison. This was the time of the Paris riots, with students hurling cobbles and the *flics* hurling tear-gas back; the first convulsions over the war in Vietnam; the Prague spring, quickly crushed by Soviet tanks; and everywhere the sense that the young, by sheer numbers, could overthrow the established order and make the world again.

If they failed to remake it, this was largely because they were out of it on one illegal substance or another. For many of them, the drug scene was a quick, soggy spliff behind the bike sheds, or a reverential division of a cake of greenish powder, washed down with a glass of Liebfraumilch and covered up with burning joss sticks. Yet at the highest levels of culture the new gods of rock music tripped on much more dangerous stuff, and sang about it. They did not find truth exactly, as much as yellow walruses, purple fields, kaleidoscopic skies and melting buildings, all of which were evoked in music and light shows so new and peculiar that the best way to appreciate them was by being prone and stoned yourself.

Syd Barrett was the very exemplar of this wild universe. As the leader of Pink Floyd, the highly successful psychedelic band that he christened in 1965, he wrote and sang of “lime and limpid green”, of Dan Dare, of gingerbread men and, in the band's first hit, “Arnold Layne”, of a transvestite who stole underwear from moonlit washing lines. His weird words and odd, simplistic melodies, sent through an echo-machine, seemed sometimes to be coming from outer space.

Yet there was also something quintessentially English and middle class about Mr Barrett. His songs contained the essence of Cambridge, his home town: bicycles, golden robes, meadows and the river. Startlingly, he sang his hallucinations in the perfect, almost prissy enunciation of the Home Counties. He made it possible to do rock in English rather than American, inspiring David Bowie among others. The band's first album, “The Piper at the Gates of Dawn” (1967), made Mr Barrett central, plaintively calling up the new age from some distant and precarious place.

Yet the songs were already tipping over into chaos, and by January 1968 Mr Barrett was unable to compose or, almost, to function. Dope, LSD and pills, consumed by the fistful, overwhelmed a psyche that was already fragile and could not bear the pressures of success. At concerts he would simply play the same note over and over, or stand still in a trance. If he played, no one knew where he was going, least of all himself. The band did not want to part with him, but could not cope with him; so he was left

behind, or left them, enduring drug terrors in a cupboard under the stairs in his London flat. Casualties of “bad trips” usually recovered, with stark warnings for the unwary. Mr Barrett, famously, went on too many and never came back.

Friends, especially his Pink Floyd colleagues, tried to encourage him to resurrect his career. Their attempts were heartbreaking. At various times in 1968 and 1969 microphones were put in front of him and he was persuaded to sing and play. Cruelly, the recordings of his solo efforts, “The Madcap Laughs” and “Barrett” (both 1970), caught everything: the nervous coughs, the desperate riffling of pages, the cries of frustration (“Again? I'll do it again now?”), the numbers of takes. The sleeve of “Madcap” showed a naked girl in attendance—there had been any number of those—but Mr Barrett oblivious to her, his face masked by long hair and mascara, crouched shivering on the floor.

Cambridge, where he had learned to play banjo and had proudly covered his first guitar with mirror-discs, seemed the best place to retreat to. He went back to live in his mother's cellar, boarding up the windows, and returned to the painting for which he had trained at Camberwell School of Art. Ambushing journalists were told that his head was “irregular”, and that he was “full of dust and guitars”.

Mr Barrett was now the most famous recluse in British rock. Slight as his oeuvre had been, it proved impossible to forget. His death, from complications of diabetes, brought an outburst of regret from rock stars and fans who were still following him. Tom Stoppard's play “Rock 'n' Roll”, which was playing at the Royal Court when he died, made him a metaphor for revolutionary music: in 1968 a Pan-figure piping liberation, in the 1990s a tired, grey man spotted in a supermarket.

Shining like the sun

His band last saw him in 1975 as they recorded, in “Shine on you Crazy Diamond”, a tribute to him that sounded like yet more encouragement. (“Come on you raver, you seer of visions/Come on you painter, you piper, you prisoner, and shine.”) Mr Barrett wandered in, fat and shaven-headed and hardly recognisable. As his friends sang “You shone like the sun”, he seemed to laugh sarcastically. He stayed a while in the studio, and then went away.

On the recording, a guitar player drifting in space walks through a door and finds himself in a loud cocktail party. Managers and promoters come up and flatter him, cajole him into working for them, but at last he escapes again. This time, nobody can catch him.

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Overview

Jul 20th 2006
From The Economist print edition

In **America** consumer prices rose by 0.2% in June, after increasing by 0.4% in May. Prices were 4.3% higher than in June 2005. Core prices, which exclude the volatile categories of energy and food, increased by 0.3% for the fourth month in a row, thanks to rising rents. In the three months to June core inflation set an annual pace of 3.6%, though in comments to Congress this week Ben Bernanke, chairman of the Federal Reserve, said that he expects inflation to slow.

Industrial production in America rose by 0.8% in June. It managed an annualised rate of expansion of 6.6% in the second quarter, its fastest pace since 1999. Companies are now operating at 82.4% of their full capacity, the highest rate since June 2000, suggesting little slack in the economy.

America attracted a net **capital inflow** of $69.6 billion in May, up from $51.1 billion the month before. Private investors showed a strong appetite for government bonds, even as official creditors, such as foreign central banks, sold a net $14.3 billion of Treasuries. **Consumer confidence** ebbed in July, according to the University of Michigan's survey. The decline was attributed to dearer oil, geopolitical uncertainty and falling share prices.

Japan ended its zero-interest-rate policy, raising its key rate for the first time in nearly six years, to 0.25%. The central bank said it will adjust rates gradually, and that they will probably stay “very low” for some time. Japan's Nikkei 225 index fell by 4.9% this week, the Topix fell by 5.6%.

Annual inflation in the **euro area** remained unchanged at 2.5% in June. High prices for transport fuel, gas and heating oil kept inflation above the European Central Bank's ceiling of 2%. Meanwhile, industrial production beat expectations, rising by 1.6% in May from the previous month and by 4.9% from a year earlier.

The euro area's merchandise **trade deficit** reached €3.2 billion ($4 billion) in May, from a deficit of €1.9 billion in April and a surplus of 2.3 billion a year earlier.

In **Britain** prices rose beyond expectations last month, as annual inflation increased to 2.5% in June, from 2.2% in May. The figures raised the possibility of an interest-rate hike when the Bank of England next meets on August 3rd. The minutes of its last meeting revealed that the monetary-policy committee voted unanimously to keep rates on hold.

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Output, demand and jobs

Jul 20th 2006
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2006	2007	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 3.1	Q1	+ 3.5	+ 3.2	+ 3.4	– 1.0	Q1	+ 2.7	Q1	4.9	Jun	5.0
Austria	+ 3.0	Q1	+ 2.4	+ 2.2	+ 1.9	+ 8.4	Apr	+ 1.1	Apr	4.8	Jun	5.2
Belgium	+ 2.2	Q1	+ 3.2	+ 2.4	+ 1.9	+ 7.6	May	+ 0.8	Apr	12.0	May†	12.2
Britain	+ 2.3	Q1	+ 2.3	+ 2.4	+ 2.5	– 0.7	May	+ 3.7	Jun	5.4	May‡	4.7
Canada	+ 3.2	Q1	+ 3.8	+ 3.2	+ 2.7	+ 3.1	Apr	+ 5.7	Apr	6.1	Jun	6.8
Denmark	+ 3.5	Q1	+ 0.8	+ 2.7	+ 2.2	+ 6.1	May	+ 5.3	May	4.5	May	5.9
France	+ 1.5	Q1	+ 2.2	+ 2.1	+ 1.9	+ 2.7	May	+ 1.4	May	9.1	May	10.1
Germany	+ 1.4	Q1	+ 1.6	+ 1.8	+ 1.2	+ 6.0	May	+ 3.2	May	10.9	Jun§	11.9
Italy	+ 1.5	Q1	+ 2.4	+ 1.3	+ 1.1	+ 2.9	May	+ 1.5	Apr	7.7	Dec	7.9
Japan	+ 3.8	Q1	+ 3.1	+ 3.0	+ 2.4	+ 3.9	May	– 0.3	May	4.0	May	4.4
Netherlands	+ 2.9	Q1	+ 0.7	+ 2.3	+ 2.1	+ 1.8	May	+ 8.0	Apr	5.5	Jun††	6.7
Spain	+ 3.5	Q1	+ 3.3	+ 3.3	+ 2.8	+ 7.9	May	+ 1.3	May	8.3	May	9.3
Sweden	+ 4.1	Q1	+ 4.6	+ 3.7	+ 2.8	+ 6.3	May	+11.8	May	4.8	May†	5.2
Switzerland	+ 3.5	Q1	+ 3.8	+ 2.9	+ 1.9	+ 9.2	Q1	+ 5.9	May	3.1	Jun†	3.6
United States	+ 3.7	Q1	+ 5.6	+ 3.4	+ 2.7	+ 4.5	Jun	+ 4.7	May	4.6	Jun	5.0
Euro area	+ 1.9	Q1	+ 2.4	+ 2.2	+ 1.8	+ 4.9	May	+ 0.8	May	7.9	May	8.7
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.8	Q1	+ 1.6	na	na	+15.4	May	+ 6.8	Apr	7.6	May	8.3
Greece	+ 4.1	Q1	na	na	na	+ 0.6	May	+ 9.8	Apr	9.7	Q1	10.4
Iceland	+ 5.0	Q1	na	na	na	na		na		1.3	May†	2.2
Ireland	+ 5.8	Q1	+ 4.4	na	na	+ 6.9	May	+ 4.4	May	4.5	Jun	4.3
Luxembourg	+ 5.7	Q4	na	na	na	+12.5	Apr	+ 4.6	May	4.1	May	4.0
New Zealand	+ 2.1	Q1	+ 2.3	na	na	– 2.9	Q4	+ 3.0	Q1	3.9	Q1	3.9
Norway	+ 5.4	Q1	+ 2.3	na	na	– 5.2	May	+ 6.3	May	3.7	May**	4.7
Portugal	+ 1.0	Q1	+ 1.8	na	na	+ 6.8	May	+ 2.4	May	7.7	Q1†	7.5

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡Mar-May; claimant count rate 3.0% in Jun.
§EU harmonised rate 8.3% in May. ††Apr-Jun. **Mar-May

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About sponsorship

Prices and wages

Jul 20th 2006
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2006	2007	latest		year ago	latest		year ago
Australia	+ 3.0	Q1	+ 2.4	+ 2.9	+ 2.7	+ 7.9	Q1	+ 6.0	+ 4.0	Q1	+ 4.5
Austria	+ 1.5	Jun	+ 2.3	+ 2.0	+ 1.9	+ 3.9	Jun	+ 0.7	+ 2.8	May	+ 2.3
Belgium	+ 1.9	Jun	+ 2.9	+ 2.1	+ 1.9	+ 5.6	May	+ 2.4	+ 2.3	Apr	+ 2.6
Britain	+ 2.5	Jun*	+ 2.0	+ 2.0	+ 1.9	+ 3.3	Jun	+ 2.5	+ 4.1	May†	+ 4.1
Canada	+ 2.8	May	+ 1.6	+ 2.3	+ 2.1	+ 2.5	May	− 0.3	+ 0.2	Apr	+ 2.6
Denmark	+ 2.2	Jun	+ 1.8	+ 2.0	+ 2.0	+ 4.6	Jun	+ 3.9	+ 2.9	Q1	+ 3.1
France	+ 1.9	Jun	+ 1.7	+ 1.9	+ 1.6	+ 4.1	May	+ 2.5	+ 3.3	Q1	+ 2.9
Germany	+ 2.0	Jun	+ 1.8	+ 1.8	+ 2.3	+ 5.3	Jun	+ 2.2	+ 1.1	May	+ 0.6
Italy	+ 2.3	Jun	+ 1.8	+ 2.1	+ 1.9	+ 6.6	May	+ 3.2	+ 2.6	May	+ 3.1
Japan	+ 0.6	May	+ 0.2	+ 0.5	+ 0.6	+ 3.3	Jun	+ 1.4	+ 0.6	May	+ 0.1
Netherlands	+ 1.3	Jun	+ 1.6	+ 1.5	+ 1.5	+ 6.0	May	+ 3.8	+ 1.9	Jun	+ 0.6
Spain	+ 3.9	Jun	+ 3.2	+ 3.6	+ 2.9	+ 6.5	May	+ 4.2	+ 3.0	Q1	+ 2.5
Sweden	+ 1.5	Jun	+ 0.6	+ 1.4	+ 1.8	+ 5.0	May	+ 2.4	+ 3.6	Apr	+ 2.3
Switzerland	+ 1.6	Jun	+ 0.7	+ 1.3	+ 1.2	+ 3.1	Jun	+ 0.5	+ 1.0	2005	+ 0.9
United States	+ 4.3	Jun	+ 2.5	+ 3.5	+ 2.4	+ 4.9	Jun	+ 3.7	+ 3.9	Jun	+ 2.7
Euro area	+ 2.5	Jun	+ 2.1	+ 2.2	+ 2.1	+ 6.0	May	+ 3.5	+ 2.2	Q1	+ 3.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.7	Jun	+ 1.1	na	na	+ 5.6	Jun	+ 4.0	+ 3.4	Q1	+ 4.0
Greece	+ 3.2	Jun	+ 3.3	na	na	+ 8.4	May	+ 3.0	na		na
Iceland	+ 8.4	Jul	+ 3.5	na	na	+ 7.1	Jun	+ 4.2	+ 8.7	May	+ 6.6
Ireland	+ 3.9	Jun	+ 2.1	na	na	+ 0.6	May	− 2.2	+ 2.2	Q1	+ 6.4
Luxembourg	+ 3.2	Jun	+ 2.2	na	na	+ 7.4	May	+ 7.9	+ 2.2	Apr	+ 1.0
New Zealand	+ 4.0	Q2	+ 2.8	na	na	+ 7.2	Q1	+ 4.2	+ 3.3	Q1	+ 2.5
Norway	+ 2.1	Jun	+ 1.7	na	na	+13.2	Jun	+19.3	+ 3.6	Q1	+ 4.2
Portugal	+ 2.9	Jun	+ 1.6	na	na	+ 5.8	May	+ 3.7	+ 1.5	May	− 3.3

*RPI inflation rate 3.3% in Jun. †Mar-May.

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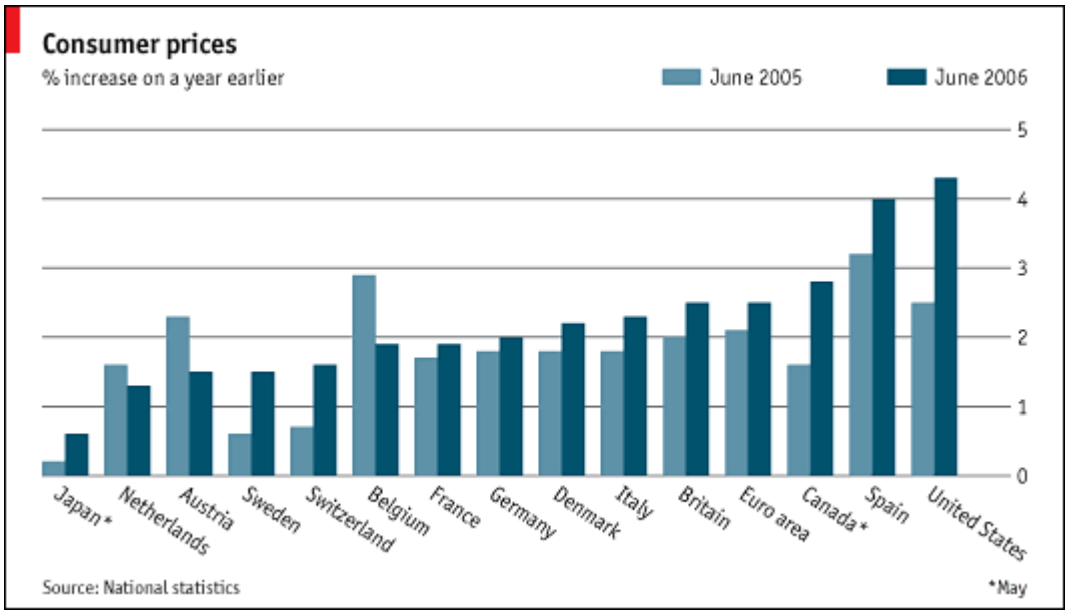
About sponsorship

Consumer prices

Jul 20th 2006
From The Economist print edition



In the 12 months ending in June 2006, American consumer prices rose 1.8 percentage points faster than they had in the preceding 12 months. Inflation has also picked up strongly in Canada. Much of the blame lies with energy prices. But energy was also costly for Austria, the Netherlands and Belgium, three countries that saw their inflation rates fall over this period.

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Money and interest rates

Jul 20th 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Jul 19th 2006)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 9.0	+ 9.8	May	6.07	5.64	5.94	5.88	5.23	6.94
Britain	+ 5.7‡	+13.7	Jun	4.70	4.58	4.76	4.62	4.34	5.68‡
Canada	+11.9	+ 6.5	May	4.17	2.55	4.21	4.45	3.97	5.66
Denmark	+13.8	+13.2	May	3.20	2.20	3.68	3.98	3.25	5.29
Japan	+ 4.0	+ 1.2	Jun	0.33	0.02	0.75	1.85	1.27	2.00
Sweden	+ 0.6	+11.5	May	2.25	1.45	3.21	3.88	3.10	3.94
Switzerland	- 0.9	+ 1.4	Jun	1.53	0.75	1.99	2.80	1.98	2.74
United States	- 0.1	+ 4.8	Jun§	5.38	3.49	5.10	5.05	4.16	6.03
Euro area†	+10.2	+ 8.9	May	3.11	2.12	3.56	3.94	3.27	4.59

*Narrow: M1 except Britain notes and coin and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. ‡New series. §New series for broad money supply. Benchmarks: US 30-year 5.11%, Japan No. 281 1.84%. Central bank rates: US fed funds 5.25%, ECB refinancing 2.75%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Lehman Brothers, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Jul 20th 2006
From The Economist print edition

2000=100

	Jul 11th	Jul 18th*	% change on one month	% change on one year
Dollar index				
All items	180.9	177.4	+ 6.9	+ 32.1
Food	141.8	138.2	+ 3.2	+ 7.2
Industrials				
All	231.5	228.0	+10.1	+ 61.4
Nfa†	160.2	156.1	– 1.9	+ 15.3
Metals	270.3	267.3	+14.5	+ 85.0
Sterling index				
All items	148.9	147.3	+ 7.9	+ 25.7
Euro index				
All items	131.2	131.3	+ 7.6	+ 26.8
Yen index				
All items	191.8	193.1	+ 9.2	+ 37.2
Gold				
$ per oz	634.55	646.55	+13.7	+ 51.5
West Texas Intermediate				
$ per barrel	74.03	73.80	+ 7.1	+ 28.5

*Provisional. †Non-food agriculturals.

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Stockmarkets

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Market indices

	Jul 19th	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	4,881.3	5,318.2	4,708.8	– 4.2	– 8.2	+ 3.7	+ 5.7
Austria (ATX)	3,621.4	4,344.4	3,324.1	– 4.3	– 16.6	– 1.2	+ 5.2
Belgium (Bel 20)	3,660.5	3,987.3	3,445.1	– 1.5	– 8.2	+ 3.1	+ 9.9
Britain (FTSE 100)	5,778.0	6,132.7	5,506.8	– 1.4	– 16.6	+ 2.8	+10.2
Canada (Toronto Composite)	11,619.6	12,487.3	10,904.3	– 1.3	– 6.9	+ 3.1	+ 6.3
Denmark (OMXCB)	340.1	395.5	325.0	– 2.8	– 14.0	– 7.5	– 1.5
France (SBF 250)	3,406.5	3,755.6	3,244.2	– 2.1	– 22.4	+ 3.2	+ 9.9
France (CAC 40)	4,846.5	5,312.2	4,615.4	– 1.9	– 30.0	+ 2.8	+ 9.5
Germany (DAX)*	5,539.3	6,140.7	5,292.1	– 1.7	– 31.3	+ 2.4	+ 9.1
Italy (S&P/MIB)	35,980.0	38,765.0	34,850.0	– 0.9	– 28.2	+ 0.8	+ 7.4
Japan (Nikkei 225)	14,500.3	17,563.4	14,218.6	– 4.9	– 62.7	– 10.0	– 9.3
Japan (Topix)	1,475.4	1,783.7	1,458.3	– 5.6	– 48.9	– 10.6	– 9.8
Netherlands (AEX)	437.4	478.0	412.9	– 0.7	– 37.6	+ 0.2	+ 6.7
Spain (Madrid SE)	1,240.1	1,318.5	1,156.8	– 1.0	– 5.9	+ 7.3	+14.3
Sweden (Affarsvarlden Gen)	289.8	333.7	275.2	– 1.8	– 27.6	– 1.2	+ 6.8
Switzerland (Swiss Market)	7,603.6	8,122.1	7,154.9	– 1.3	– 9.6	+ 0.3	+ 5.8
United States (DJIA)	11,011.4	11,642.7	10,667.4	nil	– 6.1	+ 2.7	+ 2.7
United States (S&P 500)	1,259.8	1,325.8	1,223.7	+ 0.1	– 17.5	+ 0.9	+ 0.9
United States (NASDAQ Comp)	2,080.7	2,370.9	2,037.4	– 0.5	– 58.8	– 5.7	– 5.7
Europe (FTSEurofirst 300)†	1,299.2	1,405.6	1,238.7	– 1.0	– 23.8	+ 1.9	+ 8.5
Euro area (FTSE Euro 100)†	1,100.1	1,198.7	1,050.0	– 1.4	– 29.0	+ 1.0	+ 7.6
World (MSCI)‡	1,285.1	1,406.3	1,243.9	– 1.6	– 11.3	+ 2.2	+ 2.2
World bond market (Citigroup)††	631.6	648.4	612.1	– 0.3	– 5.3	+ 1.8	+ 1.8

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

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	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2006	2007	Exchange rate trade-weighted† 2000=100 Jul 19th	year ago	Currency units per $ Jul 19th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2006‡
Australia	− 12.7	May	− 40.6	Q1	− 5.6	− 5.2	117.4	118.5	1.34	1.33	2.46	1.68	1.14	+ 0.9
Austria	− 1.2	Apr	+ 0.5	Dec	+ 0.3	− 0.1	105.6§	105.4	0.80	0.83	1.46	–	0.68	− 1.9
Belgium	+ 13.1	May	+ 7.3	Mar	+ 1.5	+ 1.6	107.4§	107.2	0.80	0.83	1.46	–	0.68	− 0.4
Britain	−128.1	May	− 52.3	Q1	− 2.9	− 2.9	100.4	97.2	0.54	0.58	–	0.68	0.46	− 3.4
Canada	+ 59.9	May	+ 31.8	Q1	+ 2.1	+ 1.1	127.6	118.7	1.13	1.22	2.08	1.42	0.97	+ 2.2
Denmark	+ 8.5	May	+ 5.1	May	+ 2.3	+ 2.2	106.3	106.1	5.94	6.21	10.9	7.46	5.07	+ 3.3
France	− 31.7	May	− 33.4	May	− 1.8	− 1.5	108.3§	108.0	0.80	0.83	1.46	–	0.68	− 2.9
Germany	+189.9	May	+108.1	May	+ 3.7	+ 3.8	109.9§	109.5	0.80	0.83	1.46	–	0.68	− 3.1
Italy	− 19.9	May	− 30.3	May	− 1.6	− 1.5	107.9§	107.6	0.80	0.83	1.46	–	0.68	− 4.2
Japan	+ 80.6	May	+165.8	May	+ 3.8	+ 3.8	80.6	84.8	117	114	215	147	–	− 5.2
Netherlands	+ 38.6	May	+ 42.3	Q1	+ 5.9	+ 5.8	108.3§	108.0	0.80	0.83	1.46	–	0.68	− 0.5
Spain	− 99.9	Apr	− 91.2	Apr	− 7.7	− 7.7	105.8§	105.6	0.80	0.83	1.46	–	0.68	+ 1.1
Sweden	+ 20.1	May	+ 23.2	Q1	+ 6.6	+ 6.1	97.9	95.0	7.36	7.87	13.5	9.25	6.28	+ 1.7
Switzerland	+ 7.2	Jun	+ 51.7	Q1	+13.4	+12.5	106.0	105.8	1.25	1.30	2.30	1.57	1.07	− 0.2
United States	−822.8	May	−808.5	Q1	− 6.8	− 6.9	84.5	87.2	–	–	1.84	1.26	0.85	− 3.6
Euro area	− 5.1	May	− 39.2	Apr	− 0.4	− 0.3	118.3	116.4	0.80	0.83	1.46	–	0.68	− 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 7.1	May	+ 10.1	May	na	na	109.0§	108.8	0.80	0.83	1.46	–	0.68	+ 2.2
Greece	− 36.8	Apr	− 23.3	May	na	na	104.8§	104.6	0.80	0.83	1.46	–	0.68	− 3.0
Iceland	− 1.8	May	− 3.1	Q1	na	na	94.0**	104.5	74.0	65.3	136	93.0	63.2	+ 2.0
Ireland	+ 38.0	May	− 5.6	Q1	na	na	113.7§	113.3	0.80	0.83	1.46	–	0.68	− 0.3
Luxembourg	− 5.1	Apr	+ 3.9	Q1	na	na	107.4§	107.2	0.80	0.83	1.46	–	0.68	− 1.7
New Zealand	− 4.8	May	− 10.1	Q1	na	na	123.0	133.9	1.61	1.49	2.96	2.02	1.38	+ 4.6
Norway	+ 57.6	Jun	+ 50.2	Q1	na	na	110.2	110.1	6.34	6.63	11.7	7.97	5.42	+ 18.5
Portugal	− 23.9	Apr	− 16.9	Apr	na	na	105.6**	106.4	0.80	0.83	1.46	–	0.68	− 5.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, May average. ‡OECD forecast. **IMF, March average.

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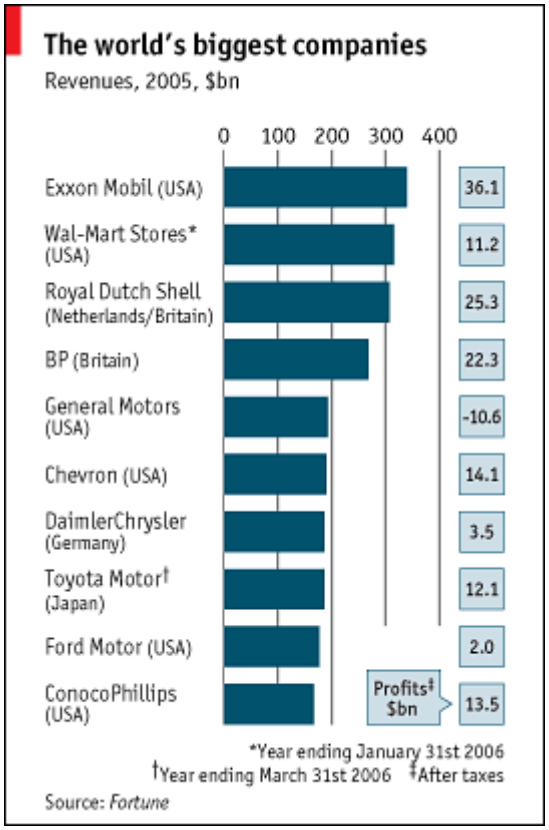
The world's biggest companies

Jul 20th 2006
From The Economist print edition



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Overview

Jul 20th 2006
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China's GDP grew by 11.3% in the year to the second quarter, thanks to strong investment and a plentiful harvest. It was the fastest expansion since 1994, prompting renewed fears of overheating.

Argentina's industrial production grew by 8.9% in the year to June, reflecting big gains in construction and carmaking.

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The cost of living

Jul 20th 2006
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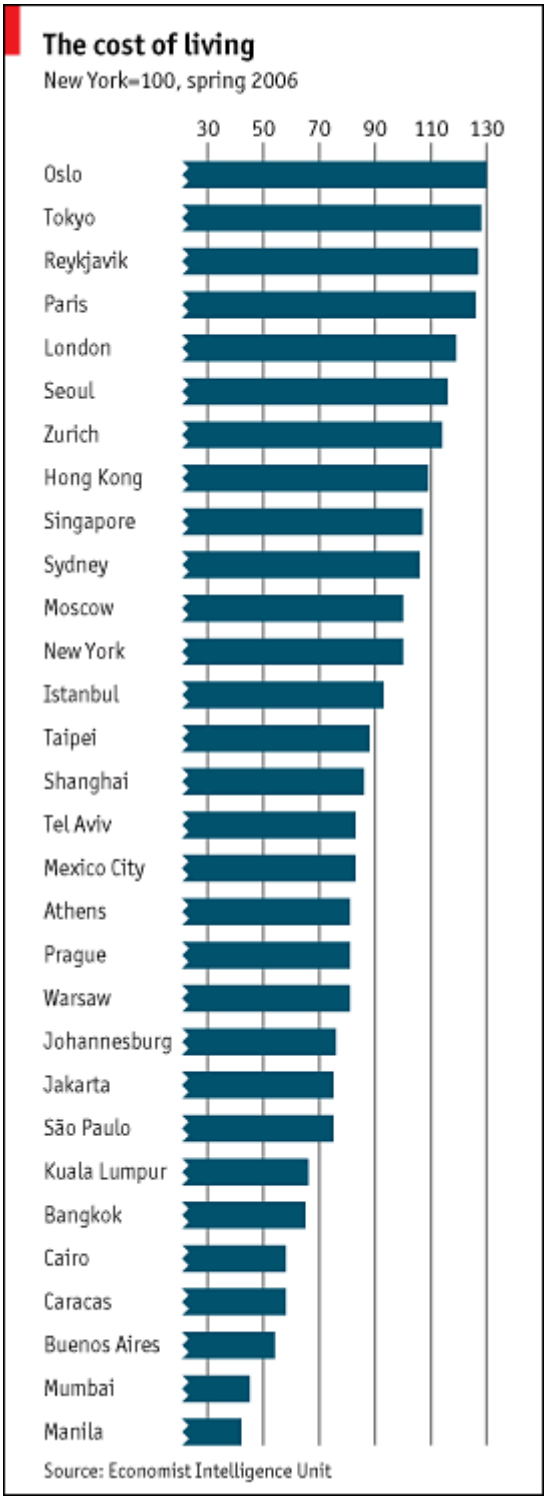
Oslo is the most expensive city in the world, according to the Economist Intelligence Unit, a sister company, which gauges the cost of living for expatriate businessmen. Alcohol, tobacco and transport all eat into executive pay packets in the Norwegian capital. Paris is pricier than London, and booming Moscow more expensive than New York. Mumbai and Manila are still relatively cheap places to live.



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Economy

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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+11.3	Q2	+17.9	May	+ 1.5	Jun	+123.0	Jun	+160.8	2005	925.0	May
Hong Kong	+ 8.2	Q1	+ 7.0	Q1	+ 2.1	May	−13.1	May	+20.7	Q1	126.6	Jun
India	+ 9.3	Q1	+10.0	May	+ 6.3	May	−51.2	Jun	−10.6	Q1	156.0	Jun
Indonesia	+ 4.6	Q1	− 3.6	Apr	+15.5	Jun	+32.7	May	+ 3.0	Q4	40.8	Apr
Malaysia	+ 5.3	Q1	+ 5.5	May	+ 3.9	Jun	+26.9	May	+19.5	Q1	79.0	May
Pakistan	+ 6.6	2006†	+19.3	Sep	+ 7.7	Jun	−11.2	May	− 4.8	Q1	11.4	May
Philippines	+ 5.5	Q1	−13.9	Apr	+ 6.7	Jun	− 3.6	Apr	+ 2.9	Mar	18.2	Jun
Singapore	+ 7.5	Q2	+10.6	May	+ 1.1	May	+33.4	Jun	+36.1	Q1	128.7	Jun
South Korea	+ 6.1	Q1	+11.6	May	+ 2.6	Jun	+18.2	Jun	+ 8.9	May	224.3	Jun
Taiwan	+ 4.9	Q1	+ 8.6	May	+ 1.7	Jun	+10.7	Jun	+18.1	Q1	260.4	Jun
Thailand	+ 6.0	Q1	+ 8.9	May	+ 5.9	Jun	− 3.7	May	+ 1.2	May	56.0	May
Argentina	+ 8.6	Q1	+ 8.9	Jun	+11.0	Jun	+11.6	May	+ 6.7	Q1	23.0	May
Brazil	+ 3.4	Q1	+ 4.8	May	+ 4.0	Jun	+44.7	Jun	+12.7	May	63.4	May
Chile	+ 5.1	Q1	+ 6.9	May	+ 3.9	Jun	+15.0	Jun	+ 0.8	Q1	17.6	Jun
Colombia	+ 5.2	Q1	− 1.8	Apr	+ 3.9	Jun	+ 1.1	Apr	− 2.0	Q1	14.3	Jun
Mexico	+ 5.5	Q1	+ 5.7	May	+ 3.2	Jun	− 3.8	May	− 1.2	Q1	81.4	May
Peru	+ 6.5	May	+ 2.7	May	+ 1.8	Jun	+ 6.0	May	+ 0.7	Q1	13.3	May
Venezuela	+ 9.4	Q1	+21.0	Mar	+11.8	Jun	+34.8	Q1	+28.1	Q1	22.3	May
Egypt	+ 5.9	Q1	+ 4.0	2005†	+ 6.4	Jun	−11.2	Q1	+ 2.1	Q1	21.8	Jun
Israel	+ 5.2	Q1	+ 2.7	Apr	+ 3.5	Jun	− 8.0	Jun	+ 4.4	Q1	27.5	Jun
Saudi Arabia	+ 6.5	2005‡	na		+ 2.4	Apr	+134.3	2005	+90.7	2005	27.2	May
South Africa	+ 4.0	Q1	+ 5.1	May	+ 3.9	May	− 6.1	May	−11.7	Q1	21.5	Jun
Czech Republic	+ 7.4	Q1	+12.2	May	+ 2.8	Jun	+ 1.5	May	− 3.4	Q1	30.4	Jun
Hungary	+ 4.6	Q1	+ 7.4	May	+ 2.8	Jun	− 3.1	May	− 7.9	Q1	21.8	May
Poland	+ 5.2	Q1	+12.4	Jun	+ 0.8	Jun	− 2.6	May	− 4.2	May	46.4	May
Russia	+ 5.5	Q1	+10.6	May	+ 9.1	Jun	+136.0	May	+93.5	Q1	243.2	Jun
Turkey	+ 6.4	Q1	+ 9.0	May	+10.1	Jun	−49.1	May	−28.7	May	59.6	May
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+11.6	Q1	+11.3	May	+ 4.3	Jun	− 2.7	Apr	− 1.5	Apr	2.2	Apr
Latvia	+13.5	Q1	+ 2.3	May	+ 6.3	Jun	− 3.5	May	− 2.3	May	2.6	Apr
Lithuania	+ 8.1	Q1	na		+ 3.7	Jun	− 3.9	May	− 1.8	Apr	4.0	Apr
Slovakia	+ 6.3	Q1	+11.4	May	+ 4.6	Jun	− 2.9	May	− 4.7	Mar	16.2	Apr
Slovenia	+ 5.1	Q1	+ 9.8	May	+ 2.9	Jun	− 1.7	May	− 0.3	Apr	8.3	Mar

*Excluding gold, except Singapore and China; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

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	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Jul 19th		Dec 30th 2005	
	Jul 19th	year ago	Jul 19th	% a year		one week	in local currency	in $ terms
China	8.00	8.28	14.7	2.73	1,729.7	– 5.5	+ 41.7	+ 42.9
Hong Kong	7.78	7.78	14.3	4.45	16,097.5	– 2.6	+ 8.2	+ 7.9
India	47.0	43.5	86.4	6.38	10,007.3	– 8.4	+ 6.5	+ 2.0
Indonesia	9,255	9,853	17,025	12.97	1,280.5	– 4.9	+ 10.1	+ 17.1
Malaysia	3.70	3.80	6.80	3.92	912.0	– 1.8	+ 1.4	+ 3.7
Pakistan	60.3	59.7	111	9.77	10,198.8	+ 2.8	+ 6.7	+ 5.8
Philippines	52.7	55.9	97.0	7.88	2,181.6	– 2.2	+ 4.1	+ 4.7
Singapore	1.59	1.69	2.92	3.56	2,341.8	– 3.3	– 0.2	+ 4.3
South Korea	958	1,043	1,762	4.62	1,233.7	– 4.9	– 10.6	– 5.6
Taiwan	32.9	31.9	60.5	1.79	6,277.2	– 5.4	– 4.1	– 4.3
Thailand	38.1	42.1	70.2	5.40	660.1	– 3.8	– 7.5	– 0.6
Argentina	3.08	2.86	5.67	9.94	1,662.5	– 2.3	+ 7.7	+ 5.8
Brazil	2.18	2.36	4.02	15.19	36,785.5	+ 1.5	+ 10.0	+ 17.6
Chile	542	574	997	5.40	9,791.4	– 0.4	+ 6.4	+ 0.5
Colombia	2,542	2,315	4,676	6.45	8,345.9	– 0.7	– 12.3	– 21.1
Mexico	10.9	10.6	20.0	7.05	19,871.8	+ 2.3	+ 11.6	+ 9.0
Peru	3.24	3.25	5.96	4.50	8,614.8	– 2.2	+ 79.4	+ 89.8
Venezuela	2,637§	2,587§	4,851	10.17	32,758.1	+ 4.9	+ 60.6	+ 57.5
Egypt	5.75	5.77	10.57	8.88	44,093.5	– 6.5	– 20.4	– 20.5
Israel	4.46	4.57	8.20	6.68	794.8	– 0.2	– 4.0	– 0.8
Saudi Arabia	3.75	3.75	6.90	5.32	10,485.1	– 11.7	– 37.3	– 37.3
South Africa	7.11	6.70	13.1	7.75	20,795.6	– 3.7	+ 14.9	+ 2.5
Czech Republic	22.6	25.1	41.6	2.31	1,343.8	– 2.5	– 8.8	– 0.7
Hungary	221	205	406	6.80	20,946.6	– 6.2	+ 0.8	– 2.3
Poland	3.17	3.44	5.84	4.19	42,278.5	– 2.9	+ 18.8	+ 21.9
Russia	27.0	28.7	49.7	11.50	1,481.9‡	– 4.5	+ 23.6	+ 31.7
Turkey	1.56	1.34	2.87	20.44	33,554.4	– 6.3	– 15.6	– 27.0
EM (MSCI)*	1.00	1.00	1.84	na	711.1	– 5.5	+ 0.7	+ 0.7
EMBI+†	1.00	1.00	1.84	na	373.6	+ 0.7	+ 1.3	+ 1.3

*Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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